Time to Talk about Smart Growth and Restructuring in Eurozone Countries

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Many economists are questioning the present austerity focus of eurozone countries and arguing that restructuring alone is not going to solve eurozone problems – neither those of Greece, Portugal, Italy, Spain and Belgium, nor those of France, and maybe not even Germany's problems. It will result in a painful, long period of inexistent or slow growth. In extreme cases, it may even increase debt to GDP as a result of GDP shrinkage. Some economists have even been arguing in favour of avoiding restructuring, and focusing instead on growth *via* continuing deficit spending. Growth with miserable, uncompetitive structures, on the other hand, will be hard to achieve; and deficit financing hardly leads to competitiveness for ailing countries in the EU (and globally). The goal of restructuring must be to lay the ground for healthy growth again; i.e. to create a competitive cost structure and organization to allow sustainable growth and to rebuild a solid balance sheet in order to regain confidence of financial markets. An aggressive growth program must be based on healthy structures, thus in most national turnaround cases growth programs will follow restructuring programs.

Restructuring national economies is a similar process to business restructuring, and not only in terms of objectives: many experiences in goal-setting, structure and the processing of programs can be shared. If we compare it to industrial restructuring, both also call for an initial focus on the impending disaster, in order to motivate and mobilize all forces to accept tough restructuring – without much talk of growth as an unlikely immediate escape, only with a rough positive vision of a more competitive and brighter future. Growth in unhealthy structures will be miserable and will only lead to more deficits or losses. You have to earn your right to grow – namely to prove that you are really on the way to become competitively viable. Such developments are powered by skilled leadership to create a will and motivation to go through massive change to create a better future.

Thus expert turnaround managers in industry have learnt to intelligently combine both restructuring and growth actions: turnaround managers focus on growth only when restructuring of the enterprise has been accepted by all parties. Management and labor need to see the abyss, and leaders subsequently need to motivate everyone to restructure; and only after restructuring actions are accepted and on the way to implementation can experienced turnaround managers talk about growth. Of course, good industrial restructurers know that the financial and social cost of restructuring can be significantly mitigated if they find healthy areas of business where they can start a growth program immediately. Therefore, as soon as restructuring actions take hold and healthier structures (promising competitiveness) are visible, experienced restructurers call for an all-out growth effort in healthy business areas; then they put the same emphasis on growth and restructuring programs. Growth becomes an entrepreneurial obligation. Such growth often includes a shift in business portfolio; for nations this may mean growth from investment, not simply consumer driven growth; or growth shifting from solely agriculture and construction to higher value-added industry sectors.

Restructuring is a prerequisite for growth in over-indebted nations just as it is for over-indebted enterprises. Moreover, reducing budget deficits and debt by austerity is a good start towards achieving a sustainable financial eurozone again, but it is only part of the job. Fiscal and structural renewal is also much more difficult without growth. Intelligently combining restructuring and growth – the expert way of a successful turn-around – may well be best for nations, just as it is for companies. Both enterprise and nation leaders know that without a growth program, restructuring creates the socially unacceptable hardship of lay-offs, and that without a positive growth perspec-

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tive the restructuring motivation will not hold very long. Furthermore, investors won't believe in the success of a turnaround if a credible medium-term growth plan is not visible.

On the other hand, it is worth remembering that restructuring can be much more than deficit and debt reduction, and that growth is not equal to deficit spending. Restructuring can mean regulatory restructuring of parts of the economy and regulation for more competition, as EU history shows. All the successful regulatory EU measures to open closed markets to competition, thus restructuring entire industry sectors (like telecommunications), donned growth wings to players in these markets through competition. Similarly, growth can be different from deficit spending: EU climate initiatives *via* standard setting and incentives are highlights of growth without deficit spending (the ill-fated PV subsidies in Germany being the exception, not the rule) and mobilizing private sector investment (instead of taxpayers' money) may be the call of the day. Growth without deficit spending should be called 'smart growth'.

It was by no means just the 2008 financial crisis that created such a great need for restructuring in the eurozone: the euro project that was so successful at the outset had some basic design flaws that have become only apparent after 10 years (pointed out early on by David March and others). Financially less-disciplined eurozone countries (deprived of the devaluation adjustment option) ran into cost competitiveness, inflation and trade balance problems and accumulated unsustainable debt to finance imports, overspending on consumption, unviable real estate projects, etc.

After 10 years of running off-track in the eurozone, we now have to create a well-balanced, but forceful program of restructuring and growth for the eurozone and the EU. In view of the massive fear and distrust of financial markets, and increasingly also of the populations of southern eurozone countries, a complete program package may not only be the way to repair eurozone economies, but may also be the best way to restore the confidence of financial investors. The key measures of such a program are listed and discussed below:

- Stop the vicious cycle of mistrust; recreate financial stability and discipline in the eurozone
- Differentiate cost reduction and growth measures across the entire EU
- Restructure for competitiveness, entrepreneurship and innovation
- Create longer term growth driven by investment in the EU
- Create a renewed vision for an attractive EU and eurozone
- Evolve EU governance

While the first of these actions is a specific eurozone task, all other repair points most likely involve all EU countries, and not only the eurozone. Moreover, even if not affected by euro design flaws, large non-euro parts of the EU were affected by excessive debt problems stemming either from the last financial ABS crisis like Britain, or of their own making like, for example, Hungary.

Stop the vicious cycle of mistrust, recreate financial stability and discipline in the eurozone

Let's be glad to have financial markets that demand financial discipline from the EU, and in particular from all eurozone countries. Markets and market interest rates don't allow governments to simply postpone the pain of solving the debt problem and repairing euro flaws. At last, every lender has understood the need to differentiate the risk along financial discipline of individual countries again, forcing weak governments to get deficit spending and debt level back under control by imposing high interest rates.

The eurozone finance ministers and heads of state have done well to address the issue of financial discipline and thus start the restructuring process. Placating financial markets by Eurobonds or ECB unlimited bond purchases would only have covered up unsustainable debt problems, as well as the trade balance and competitiveness problems of some eurozone countries. (Financial markets in the short term are not focusing on solving the underlying problem of excessive debt; they ask only for a guarantor for debt payback.) Yet financial markets also see the eurozone design flaws that led to its competitiveness problems, balance-of-payment problems and over-indebtedness. In addition, investors do not yet see the attractive growth and investment conditions aspired to in most of the EU, which dominated the launch of the common market and later of the visionary Lisbon agenda. To escape from the present 'excessive debt and low growth trap', the eurozone needs to deleverage again and fix euro design flaws; while the EU as a whole needs to overcome decade-old growth problems.

Overall, more comparisons with and lessons from the United States – the only federation of states with a common currency – should be useful.

- *Stabilize eurozone banks short term and to stop the vicious cycle of mistrust:* some first effective measures have been taken, i.e. short-term ECB liquidity support and recapitalization rules for eurozone banks; and – at the pressure of G20 – a credible firewall around large euro-economies is being built. Strengthening the ESM euro defense needs to be continued to a level so that, together with the IMF, it could refinance countries like Italy and Spain for several years, if they were denied access to financial markets. The extremely cheap ECB liquidity facility is buying time (3 years) that will hopefully be well used by banks to restructure aggressively and to recapitalize. However, it also eliminates market forces and drives away private capital that would require a much higher risk premium. National or (better in the context of more EU integration) European regulators have to replace market pressure for bank restructuring now. The question of how to win back these private capital providers at the end of the three year period still remains. Moreover, with time bought for Greece by the second bail-out, the need has not disappeared to prepare EU banks for possible further debt restructuring in the future, or for the effects of a final failure of the weakest country.
- *Repairing eurozone design flaws:* to recreate financial stability and discipline, the root causes of the crisis have to be addressed by repairing euro design flaws parallel to deleveraging. There was too little discussion of early design flaws in the common currency, which included little differentiation of interest rates for very diverging nation debtors, contradiction of Maastricht and EBA rules misguiding markets, no rule enforcement, a target credit scheme without sound collaterals, no integrated fiscal and economic governance. Misguided markets in the eurozone (taking nation debt as 100-percent safe according to EBA rules, not requiring underlying equity) were allowing undisciplined, weak, fragmented democracies to accumulate government debt up to 200 percent of GDP; weak governments on the other hand were tempted by unreasonably low, non-differentiating interest rates to raise living standards by debt financing (spending on consumption, generating cost inflation by increasing salaries and pensions while missing investment for next generation). As a result, the eurozone was sent on a track of diverging competitiveness of eurozone countries and resulting trade and balance-of-payments problems; fiscal (and economic) divergence in lieu of convergence; contributing as a consequence to unemployment and increasing social inequality in many countries and across the eurozone. One could say that these ill effects of the euro design flaws were recognized too late in view of the well-recognized advantages of the common currency. They need to be fixed even faster than the much talked about, unsolved problems of global reregulation of financial markets. Yet all of these flaws can be fixed and this crisis is a good opportunity to do so.

  - Repairing euro currency rule design flaws (one interest rate fits all, contradiction of Maastricht and EBA rules, no rule enforcement, target credit scheme without reliable collaterals, no integrated fiscal and economic governance) has not been discussed enough yet by euro politicians busy with short-term fire-fighting. Committing all eurozone countries (and even more) to return finances back to 'Maastricht-plus' criteria is only the beginning; the EBA will have to abandon the rule of no underlying equity for EU countries' national debt; most urgently, the target-2 credit system (analyzed well by Hans-Werner Sinn recently) will have to be reworked with a repayment scheme for outstanding debt possibly along the lines of Fed ISA balances in the United States with gold backed securities. There may be other ways to secure target credits with the assets of debtor countries or to restrict the capability of national central banks to print money. There may be more to be copied from the US dollar: mismanaged US states are not bailed out by the central government and yet the dollar as a currency is still easily defended by the Fed. All such changes may need to come in several steps to avoid system shocks. They may also require significant pressure from creditor countries, which have to convince a majority of debtor members in the euro system.
  - Repairing economic governance design flaws: if the (still to be ratified 25 times) Maastricht-plus treaty is the beginning of stronger financial and economic integration of the eurozone, the real challenge of an economically balanced eurozone lies in reducing the economic imbalances of north and south in the eurozone, in avoiding excessive trade imbalances by improving the competitiveness of the south and by stimulating

imports of the healthy north. The EU has to reverse the divergence of the past 10 years whereby Germany reduced the cost of its labor in real terms and reformed social systems, while southern eurozone countries fell back into inflationary economic policies. We need EU control and guidance to ensure the competitiveness of economic, labor, social policy in eurozone countries, if not in the entire EU (allowing enough differentiation as for competing states in the United States). Accepting an Economic and Finance Commissioner for the eurozone who can enforce financial discipline and true economic convergence/competitiveness may be the outcome. For catastrophic countries, controlling or even managing the stabilization of finances centrally from Brussels or *via* the Troika has almost become the proven short-term transition process.

- Eurobonds, not for national debt and only after fiscal and economic integration, reestablishing no-bail-out for member states: comparing the dollar and euro or the United States and eurozone, it is hardly ever mentioned that Michigan and California or any other state would never issue joint bonds. US Treasury bonds are issued by the central government to finance a possible central budget deficit, but not state debt. Eurobonds for the European Commission can only come after fiscal and economic integration. It is true that in the United States, as well as in a fiscally integrated EU, the central 'government' might issue Eurobonds to finance EU growth programs (like cross-EU infrastructure, e.g. a HVDC energy transmission network across Europe, cross-EU high-speed rail lines or large innovation projects similar to Galileo) or other centralized programs, which are supporting all member states, as long as member state accept that, and as long as a solid central balance sheet allows. Eurozone states may be ready for this next step in EU integration soon. They would need a central finance minister in Brussels who can guarantee the financial discipline of an EU government. Still, like the US finance minister, s/he will still not be able to ensure the financial discipline of every member state, i.e. Italy and Spain like California will have to clean-up their balance sheet on their own. Re-establishing the no-bail-out principle like in the United States and developing an 'orderly national bankruptcy' law in the eurozone is a consequence of this. The kind of Eurobonds (joint bonds for nation state debt) extensively discussed at the moment would be a consolation for all international investors (of course, any investor would only be happy with a joint bond of Italy, Spain and Belgium only if solid states are guaranteeing debt of over-indebted states). However, this would be a great mistake: it would take away today's market pressure on governments (in the form of higher interest rates) to get their house in order. At present Italy, just like California, is on its own as long as it is a financially autonomous state. Gaining and keeping the trust of financial markets (and differentiated interest rates as a measure of it) is a more reliable force of discipline than any political agreements can ever be. Yet, if northern European states want to send a credible 'No' to eurozone debt sharing *via* Eurobonds, they also have to clearly say what their euro-strategy is, namely more (even full?) fiscal integration of a eurozone federation along the US model. The crisis may be the best opportunity to move the EU forward! When will there be a better time to propose a strategy and negotiate fiscal integration if not now, when half of EU countries are close to calling for this move?
- Reregulating financial markets: an unrelenting EU political drive to reregulate international financial markets to bring them back closer to their original role of serving the real economy is also needed. This not only in defense of the common currency and in defense of eurozone country refinancing capability. The real economy, in particular industry, is also paying a high price for the volatility of raw material prices, the volatility of exchange rates and of investor behavior. Are investments which last only seconds, minutes, hours or days really to be called investments? Are hedges and CDSs without an underlying real business need ultimately very helpful to the real economy? The eurozone may have to set the tone to shift the financial industry back from self-serving and self-centeredness to a service role for the real economy. It should set the speed of the reform progress here to its own EU needs and, step by step, learn to set examples for other economic regions by unified eurozone rules, pushing for international acceptance later, but with all the power available to the core of the largest economic zone in the world.

Some elements of financial stabilization and economic integration of a 'redesigned euro'-zone have

already been addressed, but many are still missing and need to be worked-on during the next two years. In view of difficult election years for the core eurozone countries, this may call for optimism, conviction and may really stretch politics as 'the art of the possible'.

Differentiate cost reduction and growth measures across the entire EU

If our euro politicians follow the turnaround lessons of industry and make them a success route for the eurozone, the enforcement of a tough restructuring program (as we are seeing it now for many indebted countries) would absolutely be the beginning. In industry successful restructuring mangers don't shy away from setting demanding overall goals; stopping losses (deficits) and 20–40 percent cost reduction may be needed for some derailed businesses, as well as for some national economies to become competitive again. Reducing debt to sustainable levels is similarly in both cases a long, but clearly organized process of asset liquidation, and asset management.

To support ailing countries in their restructuring phase, a coordinated EU approach may help. The eurozone might differentiate austerity: fast and radical for problem countries as is well demonstrated by Ireland, Greece, Portugal, Spain and partly Italy and Britain; similar, but delayed for healthier 'growth' countries. For over-indebted countries deleveraging will start immediately, but may go on over 10–15 years: an aggressive program to reduce national debt/interest load in problem countries is what we are seeing for Greece, Portugal, Italy, and Belgium. Rightly we see it in a softer way in France and Germany. In healthier countries, deleveraging the private sector and stimulating growth may help the rest of the eurozone and finally help to deleverage the national balance sheet.

- *Drastic asset management and cost reduction.* As in any industrial turnaround, and also for over-indebted nations, the primary focus is a radical asset management program: selling off nationalized assets to reduce government debt; extremely stringent collection of outstanding tax revenues; renegotiation of payables and finally even debt restructuring. For drowning nations there may even be more dramatic patriotic asset mobilization actions. All of them start with containing the flight of capital to safe-havens abroad. Of course, governments under market and EU pressure are now reducing budget deficits in the short-term by reducing expenditure and broadening tax income through the broad brush reduction of tax preferences and of all consumption-oriented expenses. As clearly demonstrated by Britain, Italy and Spain, this includes reducing all subsidies and preferences for industries, professions, social groups and churches; reducing public services to year 2000 level, streamlining government processes, adapting social systems, e.g. pensions at 67, enforcing tax discipline and fighting corruption, building motivation to accept work, reducing the scope of overdeveloped social welfare, but still saving the weakest. In the heavy restructuring cases of southern Europe not much unrealistic talk about growth as an alternative to restructuring should be heard. Yet if restructuring were to be accepted and take hold, all energy would go into designing growth programs there too, but of a kind that does not endanger the financial rehabilitation of over-indebted countries (see below).
- *Help building sound administrations in the southern eurozone:* lack of administrative skills and discipline has not only led to delays for entrepreneurs and investment projects, tax evasion and corruption in many southern parts of the eurozone. It has even led to EU regional funds being returned to Brussels due to a lack of organizational competence and disunity. Targeted support in the reconstruction of a sound administration with the help of northern EU administration experts may be needed to make restructuring work. Supporting ailing countries with government staff from best practice country administrations may become a new way of showing solidarity in the EU and eurozone.
- *In healthier public debt situations deleverage private sector first:* differentiating between household, private (including financial) sector and national debt reduction could become part of this coordinated, differentiated EU strategy (whereby the sum of the three debt loads often ends up at 300 percent of GDP while good cases are below 150 percent). Private sector debt reduction is needed for Spain, public sector debt reduction for Belgium. Spain (with less public debt than Germany) has hesitated to restructure its over-indebted banks to avoid more public debt. Restructuring and stabilizing those banks calls for capital either from private investors, Spanish government institutions or the ESM. When the private market is refusing to engage further, taking a one-time charge in the Spanish budget, thus increasing national debt, may be the preferred solution. The right EU strategy for

healthier countries may be allowing enough profit for an overleveraged private sector, industry/financial institutions and households, to be able to shed debt first and to create a healthy equity base for growth. Resulting tax revenues should help deleveraging the national balance sheet, thus slightly delaying the national debt reduction program (not the deficit reduction program). For all healthier and stable countries, the Schäuble idea of a national restructuring fund to pay-off all debt above 60 percent of GDP may be the best solution.

- *Support weaker eurozone countries' exports by growing healthy EU countries:* to get trade back into balance and help the heavier restructuring cases in southern Europe, the EU needs to disallow the sick to continue financing their imports by debt. Creating EU (not only eurozone) growth in countries around the heavy restructuring cases will help their own feeble growth initiatives. Creating the new dynamic central and northern Europe will help the ailing southern half (and Belgium). While sticking to the agreed-upon deficit reduction targets, this would require healthy and competitive countries like Germany, Scandinavian and Baltic countries, Austria, and the Netherlands to focus on stimulating internal demand and investment, and thus on growing imports from the South. Creating consumer growth in these countries may be combined with creating investment projects. Consumer growth in Germany will hopefully result from the recent high pay increases achieved by the largest unions after a long series of abstention years, while low interest rates (today below inflation rate) stimulate construction and consumption. Respecting fiscal discipline in Germany's national budget, on the other hand, may be the best way to control a possible future overheating of the German economy, which can hardly expect ECB help *via* the raising of interest rates.
- *Transfer best practice for economic restructuring programs:* programs elements as stated for Portugal, Spain, Italy and Britain or the successful restructuring of Sweden and Finland or of Poland, the Czech Republic and Slovakia after 1990 – may help other cases and may create a new role for coordinated central EU best practice transfer. While many program elements may be partly underway for ailing countries, the EU might check where these measures also apply to healthier countries to stimulate productivity and growth.
- *Generate the will to change:* while restructuring has to be fast to be successful, much of the eurozone turnaround will be an endurance test for Europe's politicians (just as it regularly is for industrial turnaround managers). The risk lies in giving up too early when results are not immediately visible or when strong opposition arises). To be successful, eurozone politicians will have to be technically tough and strict, and must forcefully attempt a centennial culture change in the troubled eurozone countries towards greater fiscal discipline, greater tax correctness and lower corruption thanks to tough legal reforms and administrative support from best practice administrations. Yes, there will be pain. Unfortunately, however, even troubled industrial companies only change established structures like luxury overhead staffing, comfortable pay practices and fringe benefits under extreme economic pressure, and often only shed hopeless, loss-making business units in a bankruptcy restructuring. Similarly, without enormous economic pressure, most of the very troubled eurozone countries would not cut their bloated administrations, established subsidies, protected sectors and professions, unusual preferences in state-owned companies, long defended employment rules and early pension rights won by the unions in better days, or abandon centuries of tax evasion tradition. Often only the specter of state bankruptcy will generate the will and power to change all that. An easy way out, either *via* Eurobonds or debt-generated growth, would be a good way to avoid all those awkward reform measures.
- *Finally, assess the economics of a bankruptcy and a sabbatical from the euro for extreme cases:* in industry bankruptcies are accepted as a reality of life. Over-indebtedness is clearly defined and there is a legal obligation of management to report this status. Lenders generally (as long as their own survival is assured) prefer renegotiating debt to financing the agony of a company that would make unacceptable losses even without any debt over many years. They avoid throwing a lot more good money after lost money. Management or administrators, on the other hand, find greater acceptance with employees and unions for surgical cutbacks and drastic approaches to save the company, to regain profitability and competitiveness fast. Speed is essential to make the process economically efficient and to save as many jobs as possible. In delayed bankruptcy cases in industry, just like in Greece, more money may be lost by throwing good loans after bad loans and financing interest payments by international rescue funds, thus increasing unrecoverable debt further. An orderly bankruptcy of a small economy within the euro-

zone should be possible and containable with the help of an EU bankruptcy law for nations. Not only will its debt load be reduced to a sustainable level, but the Troika can stop paying itself the interest which Greece cannot pay. More importantly, a bankruptcy will give Greek politicians the pressure and freedom to make all the requisite drastic adjustments fast. To achieve the 30–40 percent cost-reduction needed within the euro may be too agonizing for desperate countries like Greece and too expensive for the eurozone; in the worst case a downward spiral will only increase the divergence of these economies from the rest of the eurozone. Devaluation goes one step further than bankruptcy within the euro. It makes an entire country poorer, yet the approach is faster and less abrasive (for all wage recipients) than 40 percent cost reduction within the euro to reestablish competitiveness. While the relationship of local salaries and prices of local products stays constant, devaluation restricts imports and calls for more indigenous production as it did so often before the euro; internationally the lowered cost base attracts investors and induces earlier suppliers to these problem countries to set up local manufacturing. Both developments lead to renewed growth in consumption, exports and jobs. Therefore after some healthy and absolutely necessary restructuring is achieved under eurozone and IMF pressure (in regulation for competition, asset liquidation, government spending, social systems and tax collection behavior), it may be cheaper to allow for devaluation in hopeless cases (almost necessarily also leading to bankruptcy-like consequences) and a restart of growth from an immediately lower competitive cost base – a sabbatical from the euro as Kenneth Rogoff called it. Once so far out of balance, it may be best to allow Greece, and potentially Portugal, to go through an orderly bankruptcy, and possibly even to leave eurozone. The cost to the rest of Europe (of an orderly bankruptcy and of saving some EU banks again) may be less than the cost of unproductive financing of Greek debt service and partly of living standards for over a decade, with a very slow recovery and with little hope of generating more competitive local industries. To assess the impact of such a decision, many experts have estimated the total debt at stake, but a reliable estimate of the total cost to the eurozone countries has of supporting a country like Greece for a decade against all economic market forces has never been published. In addition, it is surprising to observe how little our economic and financial scientists understand about the impact of a euro exit of a small country on the rest of the world economy: contagion effects and bank runs are discussed with little scientific understanding. To separate threatening estimates by affected financial institutions from independent expert estimations is difficult for eurozone decision-makers. To be on the safe side, politicians will want to avoid the contagion of larger weak countries like Spain and Italy. They will contain unjustified fears of a Greece-like fate by massive, but temporary guaranties and ESM/IMF support. Just as important may be other confidence building approaches like a faster move towards the fiscal integration of the countries remaining in the eurozone.

Regulate all EU markets for competition, entrepreneurship and innovation

Growth is not only a eurozone or indebted country issue, it is an overall EU issue. Yet for growth, we need to fix some of the decade-old overall EU problems affecting even central and northern European export countries, namely lack of investment, slow growth and lack of job generation.

Even if mature OECD countries can't hope to achieve the growth of emerging countries like BRIC, there is no reason not to try to push the EU at least to achieve above-3-percent long-term growth, the same level of growth as the United States. Specifically in this eurozone crisis, growth stimulated in healthier countries Germany, the Netherlands, Austria, Scandinavia and Eastern Europe will help the southern eurozone countries. There we finally pull the EU together again in its basic single market mission! Alas today in addition, in most countries this will need to be 'smart growth' i.e. growth without additional debt. Growth which is not financed by (now unavailable) taxpayers' money is a totally new challenge for politicians!

National economists, like managers in industries, know that there is no better force to drive investment and growth than competition. Competition drives productivity, innovation and investment. The entire common market EU idea was built on this belief. The Commission embarked on making this largest economic zone more competitive, starting with opening markets, taking away protection and barriers to entry, creating competition in nationalized or dormant sectors and successfully creating growth and jobs. The goal is to create full employment and wellbeing for Europeans. Yet, it is obvious that this job is far from complete. Lack of competition in many protected sectors with regulative restriction of access/supply and

resulting high cost/low productivity and lack of international competitiveness are still to be addressed. Also, to generate more growth from entrepreneurial investment and innovation, the EU might provide a better playing field for entrepreneurs and innovators in EU countries with all re-regulative power.

- *Continue regulation for competition to drive investment:* the EU can't do enough in restructuring all sectors for competition to create productivity, price reduction, growth, investment and jobs. Why not use this crisis to complete the common market liberalizing all still protected markets for competition and encourage cross border expansion of EU companies and entrepreneurs? This includes privatizing government holdings, outsourcing government services to private sector. The EU would finally achieve a fully open common market for energy, for rail services, telecommunication services – all combined with pan-European networks that could reduce cost significantly (e.g. reduce energy losses by 30 percent and in expensive regions reduce electricity cost by 40 percent!). The EU should realize its mission to ensure quality and consumer protection at low cost, not by nationalizing or limiting access/supply, but by transparency and supervising fair competition. Yet, consumer protection is only one task of the art of regulating market: triggering private investment and innovation is the other. Telecom regulators have learned a lot from successful and less successful deregulation initiatives about generating investment and innovation by 'smart regulation'. These lessons may help to find the right competition regulation also for utilities, posts and railways as well as to professional (lawyers, notaries, architects) and medical services/pharmacies and handicraft guilds. It might mobilize more investment and growth in transport of all kinds (less protective regulations for passenger transport; more internationalization, consolidation, organizational efficiency for freight), in retail services (land use restrictions, opening times, IT investment viable in larger entities).
- *Liberalized, best practice labor market rules:* competitive economic policies can't exclude labor market regulation and social systems. They determine to a large extent the cost-competitiveness of a country. As so often best practice needs to be analyzed. Could we imagine enlarging the EU mission to identify best practice in liberal labor market rules and social systems to be most effective for employment and re-employment? Could the EU identify best practices even to make health systems more productive? Starting with competition and open movement between systems might be a way to quickly highlight strengths and weaknesses. New rules should not protect inefficiency. The growth of many EU countries would profit from a Commission focusing on generating open, liberal, highly mobile labor markets; fostering job switches, reducing job protection (like Denmark) to increase mobility and speed restructuring; or enhancing participation in labor market, increase young people's employment (dual education/work first), increase senior and women's participation in labor market; eliminating preferences in state employment; allowing more temporary labor contracts, increasing working hours; allowing local wage bargaining, replacing minimum wages by earned tax credits; allowing immigration for skilled labor and engineering/entrepreneurial talent. Will the EU ever be able to beneficially help the introduction of best practices in the common market here?
- *More entrepreneurs for the EU:* mobilizing venture capital, changing tax law, but also starting founders programs and eliminating mundane obstacles in the EU countries, e.g. create one-stop local government service agencies for entrepreneurs. Should we not give all possible tax and other advantages to anyone who can create jobs and thus attract talents and entrepreneurs to the EU?
- *Fostering innovation-driven growth:* not research is our problem, but transfer of R&D results into application. Infrastructure and clean-tech might turn out to be two ideal lead-markets for many new technologies looking for application. Fostering regional clusters with enhanced industry/science cooperation (step-up EU cluster competition efforts and introduce rankings leading to transfer of best practice in attracting investment and in job generation) is recognized as one of the best ways to help R&D results turn into commercialization.
- *Fostering education and education effectiveness:* many of these growth initiatives need better qualified EU talent – development of engineers and other talent. Shifting tax payers' money from consumptive benefits to this most basic investment into the EU and particularly Southern countries' future is essential, as is opening the EU to skilled immigration at the same time.

Create longer term growth driven by investment in the EU

A single market mission to reduce unemployment and raise living standards across the EU can't do without sustainable economic growth. What we are missing is

a 10 years' EU growth and investment program that can double the growth potential of the EU. Confining the EU to a mature, slow growth nations' role would give up the idea of harmonizing living standards, reducing structural unemployment, would lose talents, entrepreneurs and innovators and finally would reduce the EU to a second class world citizen in this globalized century.

Indeed, most mature EU countries, Germany in particular, have reduced their investment rates as a percentage of GDP over many decades to end up at the low end of OECD rankings. 18 percent vs. 43 percent of GDP of gross capital formation for emerging economies like China shows the EU dilemma: gross fixed capital formation of EU25 countries was continuously shrinking from 25 percent of GDP to 18 percent, Germany to 17 percent in the 40 years till 2009, while China grew investment from 24 to 43 percent of GDP. German government budgets for many years have lowered investment to the legally allowed limit (equal to new debt incurred). Unfortunately not only in southern eurozone countries, weak governments focused their deficit-spending not on investment, but on today's consumption to fulfill election promises at the expense of our children. Funding investment projects useful for the next generation had lower priority. (Yes, the build-up of eastern and southern European infrastructures *via* EU regional funds has certainly generated some healthy growth there and also in supplier countries; the money exports in form of loans to increasingly uncompetitive southern eurozone countries to finance their imports was probably less healthy).

This lack of EU investment is not due to lack of funds, there is an unbelievable amount of cash – trillions of euros – searching for investment opportunities around the globe every year. It is due to lack of attractive investment opportunities and conditions in the EU which drives profitable EU industries and financial investors to focus all their free cash on investment opportunities outside Europe, mostly in the emerging countries, China or other BRIC countries. (Since most of the mature OECD countries produce a lot of business profit (today at a historical maximum as a percent of GDP) without reinvesting opportunities, the financial crisis showed how this creates new problems by excessive cash looking for returns and driving financial industry and CEOs with oversized incentives to produce more returns etc.)

For some time life has become too easy for investment decision-makers: nothing happens in Europe, consequently invest full power in the growth areas of the world outside Europe. This is surprising in view of the many opportunities which could be mobilized in the EU: building and modernizing infrastructures, modernizing cities, industry and transport for energy efficiency, economical alternative energy projects and lots of new technology application opportunities.

The only reason why austerity protagonists are hesitating to think of creating investment-driven growth opportunities is the fact that Keynesian government-funded investment programs run against deleveraging priorities of most of the EU countries, in particular our southern debt nations.

The way out of this apparent deadlock maybe multiple ways of 'smart growth' which involves a change in the role of politicians: we have to turn cash poor governments from financiers into stimulating regulators of markets (to foster competition and private investment), from investors to orchestrators of projects and from tax spenders to attractors of private financing. In addition to competition and entrepreneurship stimulus, this means above all mobilizing private funds for EU projects – privatization and PPPs large and small. It also means examining existing EU funds allocation for more effective job generating. Obviously politicians won't be driven into this role of orchestrators and fundraisers by voters clamoring for it. This will require conviction, vision, leadership and reaching-out for experience.

The most striking opportunities for the EU to generate jobs and a better future are infrastructure projects. Most of such projects can be combined with the application of new technologies. They also the best opportunity to mobilize private investors (as started in telecoms, energy and in roads); similarly energy efficiency/alternative energy investments in cities, in the industrial and transport sectors, also services. If politicians can orchestrate attractive projects in these sectors, in view of new EU investment opportunities, even European equipment industry will think twice before sending two thirds of their investment budget to non-EU markets.

- *Start with reorienting conventional EU investment funds:* an EU investment program should start with looking at existing structural and regional EU funds. EU investment funds should support the goal of increasing competitiveness of less advanced countries. They should be combined with incentives to countries for successful restruc-

turing (as Robert Zoellick also argued) and building improved administrations, like in industrial turnarounds where you invest in the business units which have successfully restructured. This would include the EIB to match investments to countries' structural reforms, reorienting unused Regional Fund to develop modern infrastructure in ailing, but successfully restructuring countries, shifting EU funds from agriculture to infrastructure and R&D, increasing funds for innovation projects. Starting a special EU infrastructure fund (EIB or EU bonds for EU infrastructure projects?) and offering significant incentives for foreign investors in ailing European regions would be a step beyond that. Building sound administrative structures in southern European countries may be a precondition though: past experience shows, money was not the issue for the poorest regions, administrative structures were missing to define and execute projects (e.g. in Sicily, Greece), regional funds awarded were returned to Brussels.

- *Politicians as project orchestrators and fundraisers:* to create sustainable growth through-out the EU through investment, in view of shrinking national budgets and overburdened taxpayers the European states will have to turn in a wholly new way to the private financial sector; they will have to become orchestrator of projects and attract global investors. There are enough investors like European and international pension funds looking for projects with 20 years' steady cash flow and returns of 4–6 percent. Infrastructure investors like Macquarie Bank or even large private equity funds like Blackstone are looking for such opportunities. The EU, EBRD, EIB, KfW and other financiers could issue bonds for long-term projects and industrial construction and equipment suppliers are ready to enter PPPs. Reducing capital exports of industry by generating attractive investment alternatives at home in the EU for industry should be one of the objectives of this EU investment orchestration program. Looking all types of financial and industry FDI (foreign direct investment) which can generate employment should be welcome in the EU, be it private institutions or sovereign wealth funds.
- *Technical Infrastructure investments:* building the infrastructure of the future will require to formulate more national and international EU investment projects, e.g. for high-speed rail from Stockholm to Napoli or Amsterdam to Bucharest or Lisbon to St. Petersburg to provide investment opportunities in the EU. Of course, the EU projects should include HVDC networks to shuffle energy from low-cost to high-cost countries, all energy efficiency investments, clean technology investments and economically viable alternative energy projects. This will need a new framework for accelerated planning and execution of EU new technology infrastructure investment programs, e.g. can we imagine taking away each of those trans-EU high-speed lines from today's railway companies, allowing consortia of these companies plus private investors (railway co's, industry and banks with pension funds etc.) to bid for construction and operation of the tracks? Governments' role will be to support them with accelerated legal processes for rights of way and construction concessions. Then EU transport ministers could potentially auction the high-speed train services to another set of consortia as a second step? In smaller projects proven PPP (public private partnership) approaches may be adequate. There has been talk about EU infrastructure bonds to finance cross-EU infrastructure projects: international investment and pension fund managers would most likely find such bonds much more attractive than financing consumptive expenses of national governments. To contain over-optimism: as in all private investments, return on capital will become the final decision variable in such infrastructure projects and will lead to a healthy priority listing of these projects.
- *Green growth investments:* energy savings and economically viable alternative energy technologies provide an ample field for profitable investment of the private sector. A joint EU and Orgalime study called Electra identified 30 billion euros of additional investment opportunities in the 'green' or 'clean-tech' sector in 2020. The updated Electra II report sees even higher potential, particularly in energy efficiency and 'smart cities' solutions. Similarly a Potsdam PKI study identified 6 million additional jobs in this field as a consequence of Green Growth initiatives. Of course focus should be on economically justifiable investments, not large scale subsidizing of still futuristic technologies (for which today mainly research and prototype development support may be needed). Setting energy saving targets and efficiency standards by the EU may be justified as much by reducing EU dependence on politically instable suppliers and hesitation to fund undemocratic regimes, as by climate change mitigation arguments. Helping to set EU technical standards (e.g. in electro-mobility) and EU frontrunner approaches will be the key to fast penetration of new technologies. Again, plan-

ning and concession processes will need to be accelerated. Expansion of financing schemes by EIB, national development banks or commercial banks with payback from energy savings is needed.
- *Investment in service industries is a neglected growth and productivity opportunity for Europe* (as shown well by the McKinsey global Institute MGI in comparing productive and less productive EU countries and the United States). Developing more growth and productivity in service industries might be attractive to private investors. More than ever this starts with reregulating many services for more competition and eliminating administrative restrictions (e.g. zoning and opening time laws) and outsourcing government services to free market, e.g. privatizing all types of network services, but also many government and communal services.
- *Fostering large scale application of existing recent technologies:* infrastructure and services can be lead-markets for new technology application in all EU countries, e.g. in broadband communications, energy efficiency, infrastructure, pharmaceuticals, biotech and medical services; applying more technology in government and communal services, in distribution and retail services and in medical service to increase productivity and quality to customers (e.g. digitizing all government services/public projects/bids) may also open up investment opportunities if such infrastructure is farmed out as a technology service. Retail and freight transportation (if regulation allows efficient, large entities) will attract large IT investment, thus gaining in productivity and quality of service.
- *Attracting more FDI towards the EU:* why not start a massive EU internal FDI initiative to complete participation in the common market and to mobilize growth? Incite EU companies to expand their M&A activities across the EU to cover the common market. Also, the largest market of the globe should be attractive to investors from the United States and the BRIC countries. Are we shy of funds because they come from Chinese and Indian investors? Shouldn't we allow even some state industries sale to strategic international investors who can create livelier competition in the EU?
- *Developing a growth belt around the EU:* while most of the above measures are focusing on the EU internally, Europeans have long realized the positive forces resulting from an actively developed growth belt around the EU. Europe is better positioned than the United States and China to help Eastern Europe, Turkey, Middle East and North Africa and even the rest of Africa to develop into growth zones not only based on oil resources. We have to take existing initiatives more seriously and become more creative how to help developing this growth zone 'EU plus'. For a start this means continuing more aggressively mobilizing the Mediterranean economic zone to create growth for southern Europe, taking advantage of Turkish growth dynamics, rebalancing agricultural industries for growth in northern Africa and southern EU countries.

Almost all of these regulation and private investment initiatives generate growth without massive increase of 'anonymous' national government debt, i.e. they fall into the category of 'smart growth'. This 'smart growth' has analogies in industry turn-arounds where cash for investments is lacking: joint ventures with customers, suppliers and competitors in manufacturing and sales, joint development programs, licensing technologies to competing suppliers, sale and lease-back are only a few of the ways cash poor companies emerging from restructuring employ to grow by using other investors' capabilities and finances. They are giving way something to get help for growth.

Yet modernizing 'old Europe' may require much more work and overcoming of obstacles from EU politicians in reregulation and reformation than building new infrastructures in China requires from their Chinese counterparts. Yes, will need overcoming deeply entrenched structures and practices and in many cases it will mean selling public goods to private investors and even guaranteeing a reasonable return in some of those projects or it means issuing specially secured infrastructure bonds. But I am sure our children who will use these infrastructures will prefer paying those service fees (while enjoying the comfort of the future) to paying-off debt and interest generated for consumption of our present generation. In addition they will profit from the stimulus these infrastructures provide for growth in the businesses of this next generation.

Create a new EU (and eurozone) spirit

Initiating such a large scale EU reform and investment program may in itself be the way to end euro-pessimism of many EU citizens and of financial markets. It would deserve to run under a motto that will be remembered as a historical success of the European Union. On the other hand, the present crisis is the best time for more EU integration. Never before has a large group of EU countries been asking for it – of course

with the realistic hope to get more effective help by more integration. It is the healthy eurozone states lead by Germany who have to urgently develop this strategy for further integration and who can promise help. Simply playing paymasters to fix mistakes without laying a good foundation for sustainable European wealth development may neither be wise nor enough for the further development of the European idea.

Yet, convincing citizens in the eurozone of a large sovereignty transfer to the center in the context of fiscal and economic integration of the eurozone may not be easy. It will need a much stronger display of the advantages of a common currency and of stronger fiscal/economic integration – making deeper European integration not the choice between two evils (tough restructuring or failure; trouble or isolation), but make it an attractive way forward, a common way out of the problems, a way to investment and growth.

- *Recreate an attractive EU vision:* to make the EU (and its core the eurozone) really attractive again very much asks for a renewal of the EU spirit. A widely marketed attractive EU vision will be needed – a vision that is closer to our modern EU citizens' concerns than the ever remaining original mission of a Europe without wars. Recreating a more modern vision should focus on economic growth dynamics: competition, productivity, investment, application of new technologies, education, attracting talents and entrepreneurs! The economic revitalization based on restructuring of the eurozone and aggressive growth measures of the entire EU will certainly contribute to a more positive view of the whole idea of a common market and more European integration. EU and national politicians will have to show how painful restructuring complemented by growth programs will help the largest economic zone of the world finally be one of the most financially sound and wealthy regions of the world and stay among the most dynamic economic zones of the world. Make the whole of the EU a more attractive, cohesive economic zone with a clearly visible roadmap showing how to evolve in the future. Demonstrate *via* best practice successes how the EU is becoming an attractive investment and growth area by reregulation which allows for more competition and mobility/flexibility and conditions which attract more private capital. Eurozone investment projects financed by euro-infrastructure bonds might still fit into this positive image, in particular if international fund managers jump at them. More so would be the confidence demonstration of private investor consortia investing in EU infrastructure projects. A complementary approach might be a vision of a more 'democratic Europe', with substantially more citizen involvement, more direct elections and referendums, starting with a directly elected EU president. It would certainly force national governments to lobby more for some EU causes and not only blame all unsolved problems on EU administrators. Others might go back and take some idealistic concepts from the 'Europe of the regions' of Charlemagne.
- *Emphasize cohesion nationally and in the EU:* if leaders in austerity countries want to gain the needed popular support, they will have to address soft aspects, showing empathy for peoples' sacrifices, not sacrifice people (Helle Thorning-Schmidt). They will have to demonstrate the resulting better future and they will have to show credible leadership: we have heard of pay-cuts and lay-offs for government employees, but have we heard of even larger pay-cuts for government members, members of parliament and officials to set a good example? From healthier countries, have we heard of highly visible non-financial help for southern Europe? The EU should support and reward early restructuring successes by EU investment projects, while national governments have to emphasize social cohesion to make reforms acceptable to people, push social mobility by fostering education and skill building, above all by providing jobs for the young generation. To reduce the present EU south-north conflict and bad austerity feelings, enhanced exchange efforts might be helpful, like city partnerships between more and less developed eurozone regions, apprenticeship programs and finally youth and student exchanges as have been so successfully developed by France and Germany in the 60s and70s.
- *Prove that the a repaired eurozone can provide value as forerunner of attractive EU integration:* integration is not only a political mission; Schengen and euro agreements help the economy of participating countries to flourish, help to ease life for the average eurozone citizen, to attract talent and investment, to negotiate stronger with other triade partners on the basis of a strong reserve currency. Match these economic goals with the political goals of reducing conflict, keeping peace in the core of Europe and of gaining global influence for the EU. The final success should be proven advantages – proven and accepted to the point where they attract not only the determined convergence

candidates, but also Britain, Norway and Denmark to join the euro. First we should be able to demonstrate that the joint euro liabilities and resulting financial transfers are really able to generate a group of disciplined and competitive countries again in the eurozone, even if standards of living still diverge. Then this zone could expand beyond fiscal and economic policy integration. This not only to follow a political vision of more integration, but eurozone leaders should be able to show the economical or political advantages of more integration: tax policies making it easy to move between countries; competitive, social and labor policies stimulating employment and facilitating higher mobility across the eurozone; pushing solutions to open national health systems, pension systems, other social systems and education systems for citizens relocating in the EU. Allowing more mobility and migration by opening national systems will create pressure for change.

Evolving EU governance: from what to how

While many economically minded EU executives and parliamentarians may agree with a large part of the described EU restructuring and growth program, there may be a difference of opinions in how to execute these action programs and which roles to assign to Commission, Council of Ministers, EU parliamentarians, national parliaments and specific eurozone institutions. Too soon EU-centralist might jump to work and turn an exciting program opportunity into something that resembles central planning which failed so visibly in the Comecon. Let's be clear about this, the EU was started based on a common market idea with a regulator ensuring open markets with lively competition to achieve highest productivity and competitiveness of Europe in all sectors: trying to avoid over-centralization, the EU should stick to its role of orchestrating competition wherever possible and to its subsidiary principle, not centralizing tasks that will just as effectively or even better be handled in decentralized ways.

- All regulatory actions in good hands with the EU: regulation to achieve competition, free access, mobility and growth has been in very good hands of EU commissioners and European Parliament. Similarly regulation and restructuring of banks should be led by a strong EU authority overriding national hesitation, following the US example.
- For EU infrastructure programs and related privatizations to accelerate cross-EU integrated high-speed rail and other networks, the EU proven procedures: the European Commission might take initiative to propose; Council of Ministers will agree to the program, national parliaments agree to privatizations etc., yet we do need to accelerate planning and implementation processes at the national level. EU directives might support that.
- Attracting finances into cross-EU infrastructure programs and also many decentralized programs (like fostering energy efficiency investments) might pull on the regional fund, EIB, or new financial institutions (SPVs?) complemented by similar national institutions to do the job of attracting private funds into European projects in a much larger scale than hitherto known.
- Many other parts of the action program might be designed by the EU, decided, altered and executed nationally, with the Commission remaining in the role of tracker, ranking progress and success and organizing best practice transfer, thus furthering competition of national institutions in speed of implementation.
- Yet, also actions for the eurozone might in the future not only involve Councils of Ministers and heads of state and ratification by their national parliaments. With the emerging two-tear EU the question arises will the European Parliament need a euro gremium to execute democratic control on specific eurozone issues? Will today's EU commissioners (similar to van Rompoy's double role) differentiate their action and ruling to fit special needs of euro and non-euro countries or will the EU need Eurozone-oriented commissioners ?

Many observers have remarked that all of this means we will have to evolve the EU's unique supranational democratic structure which harmonizes many policies and centralizes many functions under control of EU parliamentarians – now even more with deleveraging and growth oriented reregulation and large international investment programs – while leaving all local essentials to the national governments and parliaments.