The Europe 2020 strategy at midterm: Disappointing assessment calls for an urgent change driven by long run priorities

Policy Paper no 17

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October 2014

This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no. 290647.

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THEME SSH.2011.1.2-1

Socio-economic Sciences and Humanities Europe moving towards a new path of economic growth and social development - Collaborative project

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Abstract:

Europe 2020 tried to overcome the failures of the Lisbon Strategy. Goals set by the European commission were allowed to be adapted to take account of the starting position and the preferences of member countries ("national ownership"), the monitoring process was improved and the coordination between different policy strands institutionalized (in the European Semester), and “flagship initiatives” were aimed at initiating processes to support the strategy goals. Nevertheless halfway to the year 2020 the most important goals - the employment ratio, the reduction of poverty and research expenditure - seem to be out of reach. For the education goals the quantitative targets could be reached, but quality goals should also be monitored. The sustainability goals maybe attained because of the crisis driven stagnation in economic activity, but were set without ambition and they do not lead to a fair European contribution to limiting global warming to two degrees as envisaged in the "Energy Roadmap 2050". Neither can it be said that Europe sufficiently inverts becoming the world leader in clean technology or energy efficiency. We analyze the reasons for this underperformance and we address what urgent changes could help Europe come closer to achieving its targets by 2020. Finally we consider how economic policy should be shaped by a longer run vision of Europe’s position in the globalized world of 2050 as put forward in the WWWforEurope project by a team of 34 European research groups and funded by the European Commission.

Keywords: Economic Policy, Beyond GDP, Europe 2020 Strategy

JEL Classification: E02, E61, H12, I130, O44, O52

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Europe is heading towards missing important quantitative targets set in the Europe 2020 strategy. The gap will be specifically large for the areas of employment, poverty reduction and research expenditures.[2] Undoubtedly, some of these failures may have been aggravated by the crisis and the sluggish recovery thereafter. But this does not offer a full explanation. Firstly, the sum of the national targets set by member states was from the start already less ambitious than those envisaged at EU level. Secondly, the targets were not used sufficiently to guide policy reactions in face of the crisis. Thirdly, the reform programs initiated or imposed by the troika on Southern Europe, but also the "country specific recommendations" by the Commission to all countries in the "European Semester" did not coherently reflect the objectives of the Europe 2020 agenda. Last but not least, the EU 2020 targets played an even less important role on the agenda of the European Council meetings which concentrated on short-run problems instead of pursuing the long-run strategy. Given these four facts it is not surprising that Europe is not on track for reaching the three goals for employment, poverty reduction and research. The shortfall is the combined result of member countries not sticking to their own national targets (as set out in response to the community goals) and the Commission failing to monitor the targets persistently in a period of budget consolidation. We recommend a two tier response to the revealed underperformance: first to give priority to close as much of the gaps as possible by giving them priority in the next Annual Growth Survey in November 2014 and in the country specific recommendations as of 2015, and secondly to use the development of a vision, how Europe can be competitive in the globalised world of 2050, to sharpen the long run growth drivers like energy efficiency, renewables and quality of education.

[1] The author is thankful to Kurt Bayer, Fritz Breuss, Jürgen Janger, Claudia Kettner, Angela Köppl, Peter Mayerhofer, Thomas Sauer, Marcus Scheiblecker, Margit Schratzenstaller, Stefan Schiman, Renaud Thillaye, Gunther Tichy for critical remarks and suggestions to earlier versions of this document.

[2] Targets are within reach for energy and climate goals, but these goals were unambitious and not in line with the Energy Roadmap 2050 or with limiting global warming to 2 degrees. Quantitative goals will be reached for the education targets, but here the crisis may have incentivised people to stay longer in the education. The mismatch between labour demand and supply shows steep increases.

The disappointing score card

Continued fragmentation of economic policy

The segmentation of separate policy strands failed to be ended by the EU 2020 agenda, though its combination of goals (smart, inclusive, sustainable growth) would have offered the perfect opportunity for more coherence. The "European Semester" intended to allow better coordination between different policies, but was taken hostage by the priority of budget consolidation with insufficient attention being paid to long run goals.

As a result

- **fiscal policy** concentrated on consolidating budgets, but did not – within the consolidation path – shift expenditures or taxes so as to stimulate growth and employment;
- **R&D expenditures** were not prioritized (neither public expenditures nor incentives for private actors); for some countries they were not even protected from cuts;
- **industrial policy** returned to the forefront, but did not foster new firms and ecological innovation; flagship initiatives and key enabling technologies could not revert the downward trend of the share of manufacturing in GDP;
- **labour market policy** focused on bringing costs and productivity into equilibrium but allowed income dispersion and poverty to increase; the upgrading of skills in the least qualified segment or vocational training would reduce youth unemployment and income spread.

Targets missed or defined without ambition

- **The employment rate** is currently about 6 percentage points or 15 million people below its target for 2020. The national reform strategies as well as the structure of the so-called reform programs failed to support the creation of firms and sufficient employment opportunities for young people.
- **Poverty** was envisaged to decrease by 20 million persons but in fact increased to 124 million in 2012 so that the gap to attain the target in 2020 is 28 million of people.
- **Increasing R&D** had been a goal already in the Lisbon Agenda, but the European Community and most of the member countries are still far below the 3% goal. The share of R&D in GDP is practically stagnant which demonstrates constant neglect before, in and after 2009. The European Commission reacted by increasing the priority of R&D in the new multiannual financial framework for 2014-20. A Europe wide strategy to mobilize fund raising or private wealth for research or universities is not on the agenda.
- **Reaching the three energy and climate targets** seems possible, but this is the consequence of the stagnation of GDP and not the result of boosting energy efficiency or of substantially reducing emissions per output. Emission trading has been allowed to break down, energy taxes were not raised, and subsidies for fossil energy

not cut. Only the increase in the share of renewable energy is result of a transitory policy reorientation, however, new investment in renewable energy has decreased in Europe from 116 bn $ to 50 bn $ from 2011 to 2013[3]. Without more ambitious goals for energy efficiency and a more comprehensive switch to renewable energy the targets of the Energy Roadmap 2050 (80% to 95% reduction of carbon emissions) will be missed and Europe will not contribute its fair share towards limiting global warming to 2 degrees.

The case for an agenda-shift

Restarting growth in compliance with EU 2020 goals

Restarting growth should be at least as high on the agenda as budget consolidation. Policies to restart growth without increasing debt and deficits necessitate (i) shifting priorities in government expenditures as well as in the tax structure, (ii) increasing tax compliance in order to lower tax rates, (iii) promoting competition via the deregulation of regulated services and professions, (iv) supporting the creation of firms, entrepreneurship and SMEs and (v) combining public procurement policies with higher social and ecological standards. None of these strategies are receiving high priority in either European or national economic policies. If they were on the agenda (either of the national reform programs or the country specific recommendations), they were tried to be attained with low efforts and persistency (due to the priority of budget consolidation and the inefficiency to reduce other expenditures).

Growth to be measured by "Beyond GDP Goals"

Policies to restart growth should not aim to follow the same trajectory as before but place a higher priority on the broader "Beyond GDP goals". These can be bundled into three pillars: an income (or consumption) pillar, a social pillar (including high employment, low dispersion of wages, incentives for employability) and an ecological pillar (energy efficiency, low emissions and a sustainable use of materials). Future growth rates are predicted to be lower than past ones in industrialized countries but the impact of growth on welfare can be significantly increased if growth gets a higher employment content[4], becomes socially inclusive and ecologically sustainable by design.

Social and distributional indicators in Scoreboard, Semester and growth strategy

Social goals should be incorporated in a prominent way in the European Scoreboard Indicators and the disequilibria procedures[5]. A "Social Compact" should complement the

[3] See *Bloomberg report (Mills* 2014, p. 9).

[4] Technical progress should be less labour saving and more resource and energy saving.

[5] Social goals were included lately by "auxiliary indicators" attached to the scoreboard, but this gives a very weak legal basis. Ideally the Macroeconomic Imbalance procedure should be redesigned as an "Economic and Social Imbalance Procedure; from MIP to ESIP). This follows a suggestion of Renaud Thillaye.

fiscal compact. Social expenditure and transfers are often considered as detrimental to long-run growth, but social expenditure and standards can become growth drivers. If the social measures are activating, enhancing qualifications, improving the match between supplied and demanded qualifications, then social investment will support growth. As such a trade-off is switched into a synergy via a prudent policy.

The same holds for environmental policy. Ambitious goals for emission reductions may reduce price competitiveness, but on the other hand early innovators can benefit from a first mover advantage, leading to export gains for Europe via new technologies. Energy policy must include demand side management, optimize the whole supply and demand system and focus on energy services instead of primary energy.

The focus of environmental policy should shift from production orientation to demand side goals (e.g. standards for housing, consumer goods, transport), thus preventing leakages by imports and shifting production to countries with softer regulations.

Competitiveness should no longer be defined as low costs, but as the ability of a country to provide Beyond GDP goals (without a deficit in current account; *Aiginger, Bärenthaler-Sieber, Vogel*, 2014). High income countries have to go for a high road strategy based on innovation, education and good institutions, if they want to enhance welfare.

Strengthening macro-economic focus

One of the reasons for stagnation in Europe - often ignored in European policy design - is the lack of macroeconomic demand. On the member country level net exports can fill the demand gap. At the European level only exports to non-member countries could achieve the same. This shifts the policy focus to consumption and investment as the demand components urgently needed for boosting employment and growth. Given that lack of aggregate demand is the dominant problem, this makes calls for price competitiveness and wage restraint less convincing, if not counterproductive. Stimulating consumption draws the attention to wages rising in parallel to productivity and to the role of income distribution. The necessity to stimulate investment shifts the focus to macro governance, to boosting confidence in long term growth, to cutting red tape and realising that ecological ambition can be a stimulus of employment, investment and growth.

Shifting perspective to the European level

This calls for a reorientation of macroeconomic policy from a national level to a European perspective. The lack of investment programs (for tangible and even more so for intangible investment) and unused Structural Funds become a problem of Europe as an entity and not of individual member states. Eurobonds, the European Investment Bank and, innovative schemes of financing SMEs - inside or outside the traditional financial sector - are becoming ever more important.

The problems of tax fraud and tax evasion have to be addressed by a genuine European (or global) strategy implemented in parallel by all members. Other examples of policies which will tend to be much more successful on the European level than on the national one are mitigating climate change, emission trading, energy systems, taxing financial transactions, stabilising and supervising the banking system.

Full use of Structural Funds as joint obligation of member countries and Commission

Structural Funds had been used to boost growth and competitiveness as well as to reduce disequilibria. This impact can be strengthened by shifting the focus from large projects to smaller ones, from highways to industrial parks and software centres and to intangible investments in general (schools, training, research, broadband etc.) and to systemic solutions (energy systems, car sharing, recycling and recharging).

Currently a substantial part of the structural funds are not fully used, partly due to a lack of sufficient projects, to administrative failures or lacking national co-finance. It should be a common obligation of member countries <u>and</u> the Commission to make the full use of the programs. Member countries not able to use their share of the funds should be "blamed" and offered administrative help. If this does not lead to full utilization, the share of Community financing for the approved projects in other countries should be raised, under the condition that the funded projects are accelerated. Building up reserves in the Structural Funds of 100bn Euro or more leads to negative supply as well as demand spillovers to all European countries.

Urgency of stimulating demand

The initiative of the new presidency to boost growth by a 300 bn Euro program is laudable. To make it consistent and persuasive however, ideas how to finance it should be more explicit. The operationalization of the initiative is urgent. Business climate is stagnating at best in the second half of 2014, with signs that several countries are at the brink of a new recession. "Collecting investment projects" by December which then would be assessed at the European level is a dangerous delay. Intangible investments in human capital, research, social and ecological innovations, energy system should be part of the initiative. They have, aside from the long run supply effect, an important short run demand effect and are quicker to start.

Renaissance of manufacturing based on sustainability and human capital

A new industrial policy is currently being designed in many countries and supported by a newly proclaimed European goal, namely to raise the value added of manufacturing to 20% of GDP. This is a very ambitious target, but it may be reached if business services are added to industrial production, which together with new technologies may enhance consumer value. The boundaries of the manufacturing sector are blurred at both ends (upstream by research and downstream by value enhancing services). Speeding up key enabling

technology and progress towards "Industry 4.0" should be monitored in the European semester. If prices for fossil energy are higher in Europe than in the US this has to be compensated by funds for raising energy efficiency and by closing the gap in research, not by subsidies for fossil energy. The use of personal savings for long-run investment - specifically also for Small and Medium sized firms - should be fostered to overcome credit crunches in some countries stemming from the aftermath of the Financial Crisis.

A stabilized financial sector to support the real economy

An efficient and supportive financial sector is necessary for a dynamic economy. It should stabilize and support the real sector. Reforms are on the way, but unregulated off-shores and shadow banks escape regulation. Efforts to tax specifically short and very short run transactions have been successfully prevented by lobbying. The currently discussed type of a financial transaction tax is some sort of the stamp duty which taxes emissions of newly issued stocks and makes financing of the real sector more expensive. A restart of a genuine Financial Transaction Tax focusing on short run speculations, and including transaction with offshores, hedge funds and shadow banks is urgent. The proceeds could first be used to finance a European Investment program, then to reduce taxes on labour.

Fiscal flexibility for defined projects – contingent on independent evaluation

The fiscal pact should be made more flexible in a specific proactive way. Investment for mitigating climate change, reducing youth unemployment and boosting social innovations and renewable energy should be exempted from the calculation of maximum public deficits allowed by the Fiscal Pact. Projects qualifying for exemptions from the fiscal pact should be defined ex ante in a closed list of categories and the qualification of specific measures to these categories should be contingent on the assessment of independent authority[6]. Making the pact more flexible in the sense of exempting broad categories of tangible investment chosen by national governments is counterproductive. The call for flexibility should also not be used to postpone reforms, cutting administrative expenditures, efficiency enhancing measures and public sector reforms.[7]

[6] This is a similar idea to the proposal of "contractual agreements", Our idea is different insofar as "structural reforms" are defined more broadly – not only deregulation of the labour market, but including retraining, starting new businesses, industrial clusters – and include intangible investments. Furthermore the projects do not have to be approved in one to one negotiations between members and the Commission but to comply with ex ante defined project guidelines, and qualification is certified by independent authorities.

[7] A change in the method of calculating structural deficits (which have to be reduced according to the Fiscal pact in an economy not far below its "potential output") is absolutely necessary. This may sound like a technicality, but it is important. Currently the potential output is calculated by smoothing (un)employment rates. This has the consequence that any rate of unemployment (even above 10 or 20%) will soon be declared as structural, and not as a sign of unused production potential. The consequence is that the underutilization of the economy "evaporates", no cyclical unemployment exists, and no fiscal stimulus is needed. In this case the fiscal pact will require further consolidation that may aggravate the crisis. If long term unemployment (number of persons unemployed for more than 12 months) was used as a sign of underutilization instead of smoothing, there would be room for a fiscal stimulus.

Refocusing the Annual Growth Survey 2014 and the European semester 2015

For the next Annual Growth Survey in November 2014 it is all important to address (i) the lack of demand on the European level, (ii) the deficit in R&D relative to the target as well as to the US, (iii) the fact that Europe is missing enormous chances by not being on track for the Energy Roadmap 2050 (to boost energy efficiency and sustainable technologies).

In the next European Semester the countries should specify how they will reduce one fifth of their existing gaps in the EU 2020 strategy targets in each year as to reach them in 2020. The reasons why the majority of member countries did not provide programs for reducing youth unemployment have to be discussed (and solved if possible in 2014).

The need of a vision for Europe 2050

Europe needs a vision of where it actually wants to be in 2050 in the globalized world. In a nutshell such a vision exists in strategy Europe 2020 over a shorter horizon. But shifting the perspective to a longer horizon will sharpen the challenges, carve out the policy changes needed but also the opportunity and chances for Europe.

All long-term forecasts for Europe over the next decades predict much lower growth rates than in the past and also lower growth for Europe than in the US (partly due to ageing, partly due to a lower productivity increase). All forecasts however also predict a quick expansion of the world economic output. Thus EU 28, currently the largest economic area, will fall back to place 4 or 5 in its economic potential, and its share of global output will decrease from actual 25% to about 15%. Global emissions are predicted to grow somewhat less than output, but much faster than needed to limit global warming to 2 degrees. With growth rates below 2% p.a. as predicted, Europe will not be able to reduce unemployment or to postpone the retirement age parallel to the rising life expectancy as requested for financing the pension system.

These predictions underline the necessity to restart growth in Europe (i) to reduce unemployment and poverty, (ii) to reduce disequilibria and income difference and (iii) to limit the loss in market shares and the ability of Europe to share global economic policy and standards. They furthermore strengthen the conviction that Europe's position needs to be one of high quality production and consumption ("high road" to competitiveness). Products of a low or medium quality will not be produced in Europe in 2050 and their share in consumption is expected to decrease with rising income. This shifts the policy focus to boosting intangible investment like research, education, broadband etc.

Limiting global warming requires all countries contribute substantially to reduce the greenhouse gases, independent of their share in emissions. Europe's responsibility stems from past emissions, but should also be driven by chances to export technologies ("first mover advantage").

Lower growth indicates that unemployment problems have to be solved by shifting technological progress from labour productivity to resource and energy productivity.

Greater confidence in the success of Europe is needed and substantiated, since Europe has in contrast to the US no deficit in the current account, and a good position in several technologies (among them in social and ecological innovation) and a socioeconomic model fitting to high-income countries.

Such a longer term vision based on Europe 2020 is at the core of the WWWforEurope project[8]. It highlights the necessity to reach the Europe 2020 goals in the final years and calls for a future orientated agenda to be developed for the longer term:

"By 2050 Europe will have become a role model for a dynamic, open economic area with internal sustainability, limited income differences, an absolute decline of emissions and positive spillovers to neighbours and the world at large".

It is a long way for Europe which is currently not on track with its 2020 strategy to change to this vision for 2050. But it is a fascinating task to develop a successful "European model" for the globalized world: a dynamic, socially inclusive and ecologically sustainable society.

[8] http://www.foreurope.eu/ commissioned by DG Research & Innovation to WIFO and 32 partners. Midterm report available at http://www.foreurope.eu/fileadmin/documents/pdf/Pressreleases/WWWforEurope_Midterm_Projectinformation.pdf

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WWWFOR EUROPE
WELFAREWEALTHWORK

Project Information

Welfare, Wealth and Work for Europe

A European research consortium is working on the analytical foundations for a socio-ecological transition

Abstract

Europe needs change. The financial crisis has exposed long-neglected deficiencies in the present growth path, most visibly in the areas of unemployment and public debt. At the same time, Europe has to cope with new challenges, ranging from globalisation and demographic shifts to new technologies and ecological challenges. Under the title of Welfare, Wealth and Work for Europe – WWWforEurope – a European research consortium is laying the analytical foundation for a new development strategy that will enable a socio-ecological transition to high levels of employment, social inclusion, gender equity and environmental sustainability. The four-year research project within the 7th Framework Programme funded by the European Commission was launched in April 2012. The consortium brings together researchers from 34 scientific institutions in 12 European countries and is coordinated by the Austrian Institute of Economic Research (WIFO). The project coordinator is Karl Aiginger, director of WIFO.

For details on WWWforEurope see: www.foreurope.eu

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