Economically thinking

Past President of the European Engineering Industries Association Edward G Krubasik declares that it is time to talk about smart growth and restructuring…

Many economists are questioning the present austerity focus of Eurozone countries, arguing that restructuring alone will not solve the Eurozone problems. In extreme cases, it could possibly even increase debt to GDP as a result of GDP shrinkage. Indeed, some economists have even been arguing to avoid restructuring and rather focus on growth through continuing deficit spending with less fear of inflation. Many US experts have overlooked the fact that Europeans and most Asians have always been savers, while US Americans have always been living with more debt. Thus inflation has a totally different effect on the two groups.

As in industry, the goal of restructuring national economies should be to lay the foundations for healthy growth; to create competitive cost structures and organisations that enable sustainable growth in order to rebuild a solid balance sheet to regain the confidence of financial markets. An aggressive growth programme has to be based on healthy structures. Thus, as in industry, in most national turnaround cases, growth programmes will follow restructuring ones.

On the other hand, restructuring can be much more than deficit and debt reduction – growth is not equal to deficit spending. Restructuring can be regulatory restructuring of parts of the economy and regulation for more competition, as EU history shows. Successful regulatory EU measures to open closed markets to competition – thus restructuring entire industry sectors (as in mobile telecommunications) – resulted in significant growth of those players. Similarly, growth can be different from deficit spending: EU climate initiatives via regulation, standard setting and financing schemes based on energy savings are highlights of growth without deficit spending. Mobilising private sector investment (instead of taxpayers' money) may be the call of the day. Growth without deficit spending could be called smart growth.

After 10 years of running off track, the Eurozone (and EU) needs a well-balanced but forceful programme of restructuring and growth, including fixing euro design flaws. A complete programme package could not only be a way to repair eurozone economies, but also a method to restore the confidence of financial investors and EU citizens alike. There are five key measures that such a programme should display.

Stop the vicious cycle of mistrust

Let's be glad to have financial markets that demand 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 design flaws. At last, every lender has understood the need to differentiate the risk along the financial discipline of individual countries, again forcing weak governments through high interest rates to get deficit spending and debt level back under control.

Placating financial markets by eurobonds or ECB unlimited bond purchases would only have masked the unsustainable debt issues, 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. However, financial markets also see eurozone design flaws – the contradiction of Maastricht and EBA rules, no rule enforcement, one interest rate fits all debt, target credit scheme without reliable collaterals, no integrated fiscal and economic governance – which led to competitiveness problems, balance of payment problems and over-indebtedness.

First, more comparisons with, and lessons from, the US – the only federation of states with a common currency – should be useful. This could be in fixing target credit schemes, returning to 'no-bail-out' or mechanisms to balance economic cycles between states. Repairing economic governance design flaws comes next: if the (still to be ratified 25 times) financial discipline treaty is the beginning of stronger financial and economic integration of the eurozone, the real challenge of economic balance lies in reducing the imbalances of the North and the South in the eurozone, in avoiding excessive trade imbalances by improving the competitiveness of the South and by stimulating imports of the healthy North. Accepting an economic and finance commissioner for the eurozone who can enforce financial discipline and true economic convergence/competitiveness policies may be the outcome. Finally, an unrelenting EU political drive to re-regulate international financial markets to bring them back closer to their original role of serving the real economy is also needed. This is not only to reduce the risk of future crises: the real economy, in particular industry, is also paying a high price for the volatility of investor behaviour, exchange rates and raw material prices.

Differentiate cost reduction and growth measures

If euro politicians follow the turnaround lessons of industry and make them the success route for the eurozone, the enforcement of a tough restructuring programme (as we are seeing it now for many indebted countries) would be the absolute beginning. Stopping losses (deficits) and 20%-40% 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 similar in both cases – a long but clearly organised process of asset liquidation, cash management and debt repayment. However, to achieve a financially sustainable eurozone again is much more difficult without growth. Intelligently combining restructuring and growth – the expert way of a successful turnaround – may well be best for nations, just as it is for companies.

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The eurozone might differentiate austerity: fast and radical for problem countries, as is well demonstrated by Ireland, Greece, Portugal, Spain, and partly Italy and the UK (detailed measures are well discussed every day in the press); with similar but delayed steps for healthier growth countries. For over-indebted countries, deleveraging should start immediately and continue for 10-15 years: this is what we are seeing for Greece, Portugal, Italy and Belgium. This differentiation may include debt forgiveness or even a bankruptcy in extreme cases where IMF and EU don't see a chance for solvency and a country might see the only chance to restore competitiveness in a sabbatical from the euro.

Rightly, we see it in a softer way in healthier countries. Deleveraging the private sector and then stimulating healthy private sector growth may help deleveraging the national balance sheets and finally aid the rest of the eurozone. Specifically in this eurozone crisis, growth stimulated in healthier countries such as Germany, Holland, Austria, Scandinavia and Eastern Europe will help the Southern eurozone countries. There we finally pull the EU together again in its basic common market mission. Creating consumer growth in these countries may be combined with creating investment projects. In Germany, low interest rates (currently below inflation rate) stimulate construction investment and consumption, while consumer growth may result from the recent high-pay increases achieved by the largest unions after a long series of abstention years.

Reregulate all EU markets

Growth is not only a eurozone or indebted country issue; it is an overall EU issue. Yet for growth, we need to fix some decade-old, overall EU problems that affect even Central and Northern European export countries: lack of investment, slow growth and poor job generation. A

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common 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 year growth and investment programme that can double the growth potential of the EU. Alas in most countries, this will need to be 'smart growth', that is growth without additional debt, which is not financed by (now unavailable) taxpayers' money – a totally new concept for politicians.

National economists, like managers in industries, know there is no better force to drive investment and growth than competition. Regulating for competition does not burden the taxpayer; rather the contrary: competition drives productivity, innovation and investment to the advantage of the consumer. The entire common market EU idea was built on this belief. The European Commission embarked on making the largest economic zone more competitive, starting with opening markets, taking away protection and barriers to entry, creating competition in nationalised or dormant sectors, and successfully creating growth and jobs.

However, it can be seen 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. Why not use this crisis to complete the common market by liberalisation of still protected markets for competition? This includes privatising government holdings, outsourcing government services to the private sector. Telecom regulators have learned a lot from successful re-regulation initiatives, where 'smart regulation' generates investment and innovation. These lessons may assist in finding the right competition regulation for utilities, medical services and many other professions. It could also stimulate investment and growth in transport and retail services.

Moreover, the EU might provide a better playing field for entrepreneurs and innovators, and encourage cross border expansion of EU companies and entrepreneurs with all re-regulative power.

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Create longer-term growth driven by investment

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 (only during crisis years did money stay at home in cash producing EU countries). 18% vs 43% of GDP of gross capital formation for emerging economies, such as China, shows the EU dilemma: gross fixed capital formation of EU25 countries was continuously shrinking from 25% of GDP to 18%, for example in Germany to 17% in the 40 years till 2009, while China grew investment from 24% to 43% of GDP. This lack of EU investment is not due to lack of funds; there is an unbelievable amount of money – 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 that drive profitable industries and financial investors to focus most of their free cash on investment opportunities outside Europe, mostly in the emerging BRIC countries.

The only reason why austerity protagonists are hesitating to think of creating investment-driven growth opportunities is the fact that Keynesian government funded investment programmes run against deleveraging priorities of most of the EU countries, in particular the Southern debt nations. The path out of this apparent deadlock may be multiple ways of smart growth that involve a change in the role of politicians: we have to turn cash-poor governments from financiers into stimulating regulators of markets, from investors to orchestrators of projects, and from tax spenders to attractors of private financing.

Start with reorienting conventional EU investment funds to increase competitiveness and effective job generation. They should be combined with incentives to countries for successful restructuring and building improved administrations, as in industrial turnarounds where you invest in the business units that have successfully restructured. However, then, it means above all mobilising private funds for EU projects; privatisation; and PPPs, large and small. There are enough investors – such as European and international pension funds – looking for projects with 20 years steady cash flow and returns of 4%-6%. Infrastructure investors, like Macquarie bank, or even large private equity funds, such as Blackstone, are looking for such opportunities. The EU, EBRD, EIB, KfW and other financiers could issue bonds for long-term projects and industrial construction while equipment suppliers are ready to enter PPPs.

The most striking opportunities for the EU to generate jobs and a better future are infrastructure projects. Most such projects can be combined with the application of new technologies. They are also the best opportunity to mobilise private investors – as started in telecoms, energy and roads. Similarly, there are energy efficiency/ alternative energy investments in cities, in the industrial and transport sectors, and also in services. Building the infrastructure of the future requires the formulation of more national and international EU investment projects, for example high-speed rail connections from, say, Stockholm to Napoli (and others), or HVDC networks to shuffle energy from low-cost to high-cost countries.

Yet modernising 'old Europe' may require much more work from politicians to overcome obstacles in deeply entrenched structures and practices. It may start with PPPs, privatisation, re-regulating many industries and services for more competition, and eliminating administrative restrictions; however it will need a new framework for accelerated planning and execution of EU new technology infrastructure investment programmes. Moreover in many cases, it will also mean selling public goods to private investors and even guaranteeing a reasonable return to pension funds in some of those projects or issuing specially secured infrastructure bonds. In return, we will have jobs without more state debt and a growth base for future generations. Obviously, politicians won't be driven into this role of orchestrators and fundraisers by voters clamouring for it – but it will require conviction, vision, leadership and reaching-out for experience.

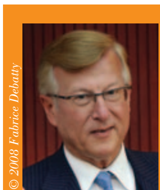
Create a new EU (and eurozone) spirit

Initiating such a large-scale EU reform and investment programme may in itself be the way to end the 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 – a competitive 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 through greater integration. It is the healthy eurozone states, led by Germany, who have to urgently develop this strategy for further integration and who can promise help. Simply paying 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.

However, convincing citizens in the eurozone of a large sovereignty transfer to the centre, in the context of fiscal and economic integration of the eurozone, may not be easy. It will need a much stronger vision (more than avoiding wars in Europe) displaying the advantages of deeper fiscal/economic integration, of a common currency and fiscal discipline 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. The goal is to create an integrated competitive Europe with full employment and wellbeing for all Europeans. Revitalised positive global political EU influence will be a natural consequence of this.

www.orgalime.org/pdf/Time%20to%20talk%20about%20smart%20growth%20and%20restructuring.pdf



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