A role for public and social investment in EU economic governance

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Europe's crisis: a problem of demand

Since 2008:

Private investment has fallen, no recovery

Public expenditure has been reduced, Deficit→0

Exports now grow less than world GDP

Consumpt: with record income inequality, lower dynamics

With no demand growth, no GDP growth

Where do we start?

- **Investment**

but **private** investment is pro-cyclical,

no effect of QE when demand is missing

- **Public investment**

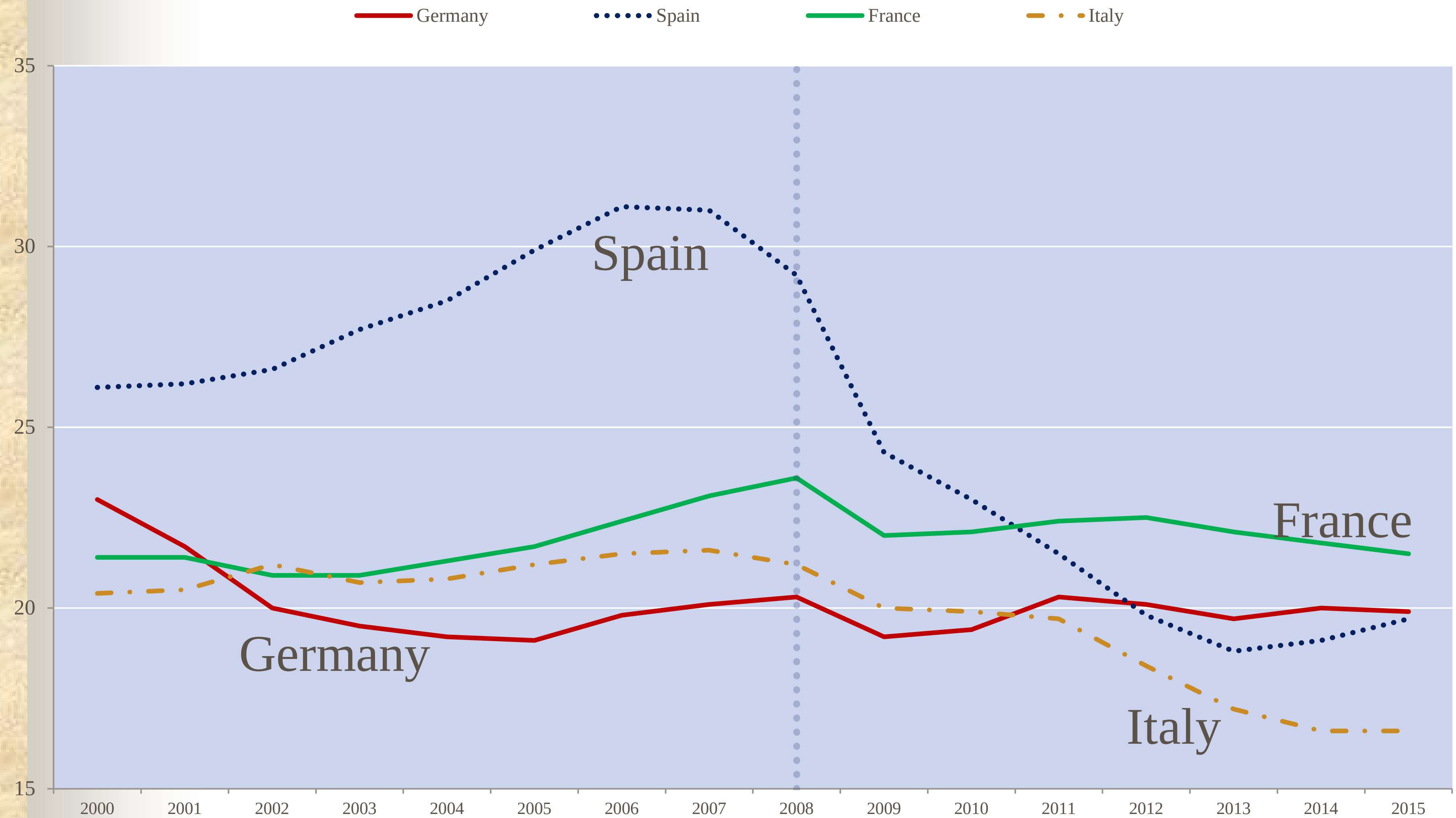
is a key policy tool, already used by Juncker plan

increases demand, improves supply structure

- **Social investment**

can improve economic growth, social cohesion, environmental quality, reduce inequality

Total Investment as % of GDP

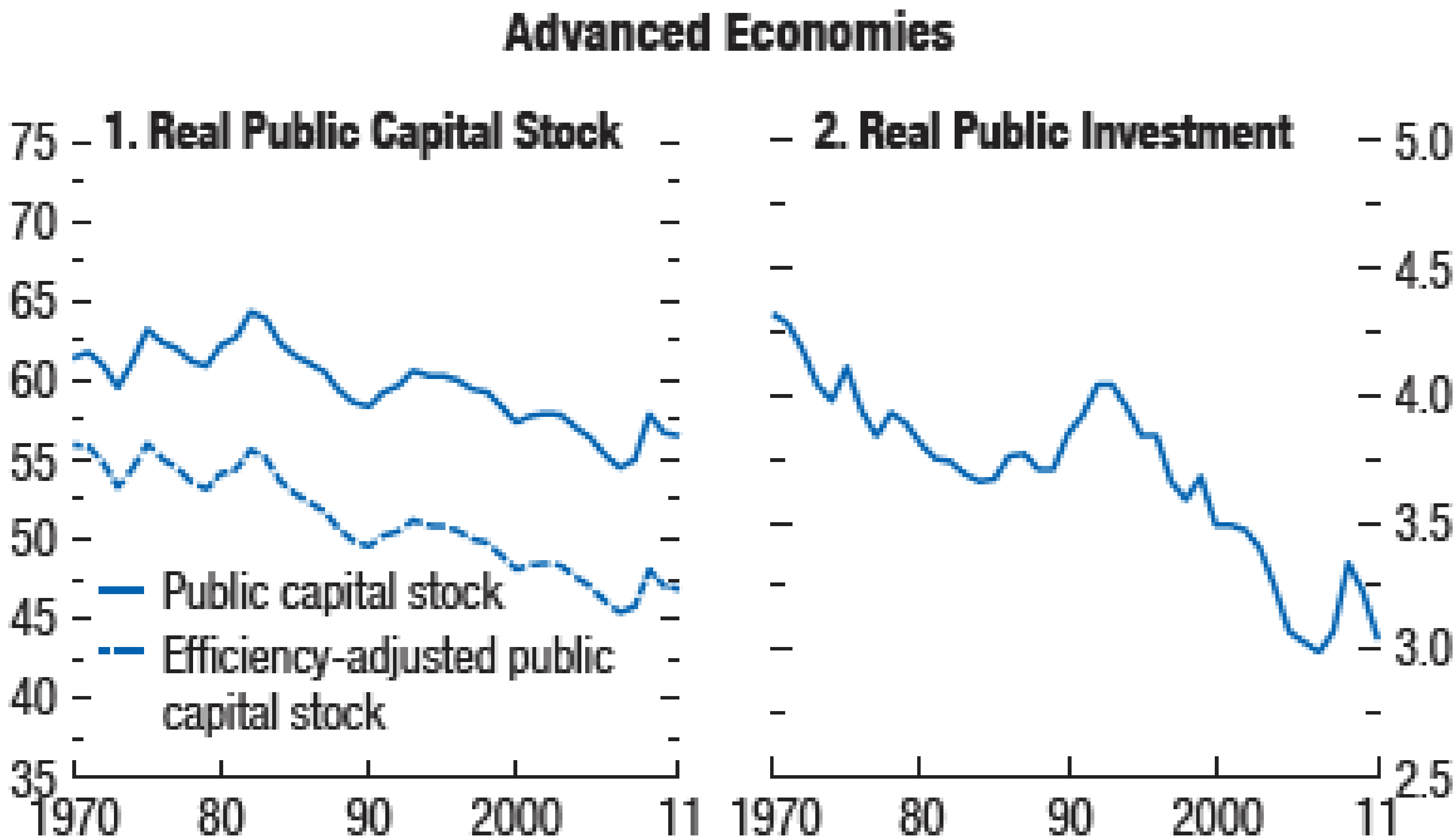


Source: Eurostat, National Accounts

IMF 2014

Figure 3.2. Evolution of Public Capital Stock and Public Investment

(Percent of GDP, PPP weighted, unless noted otherwise)

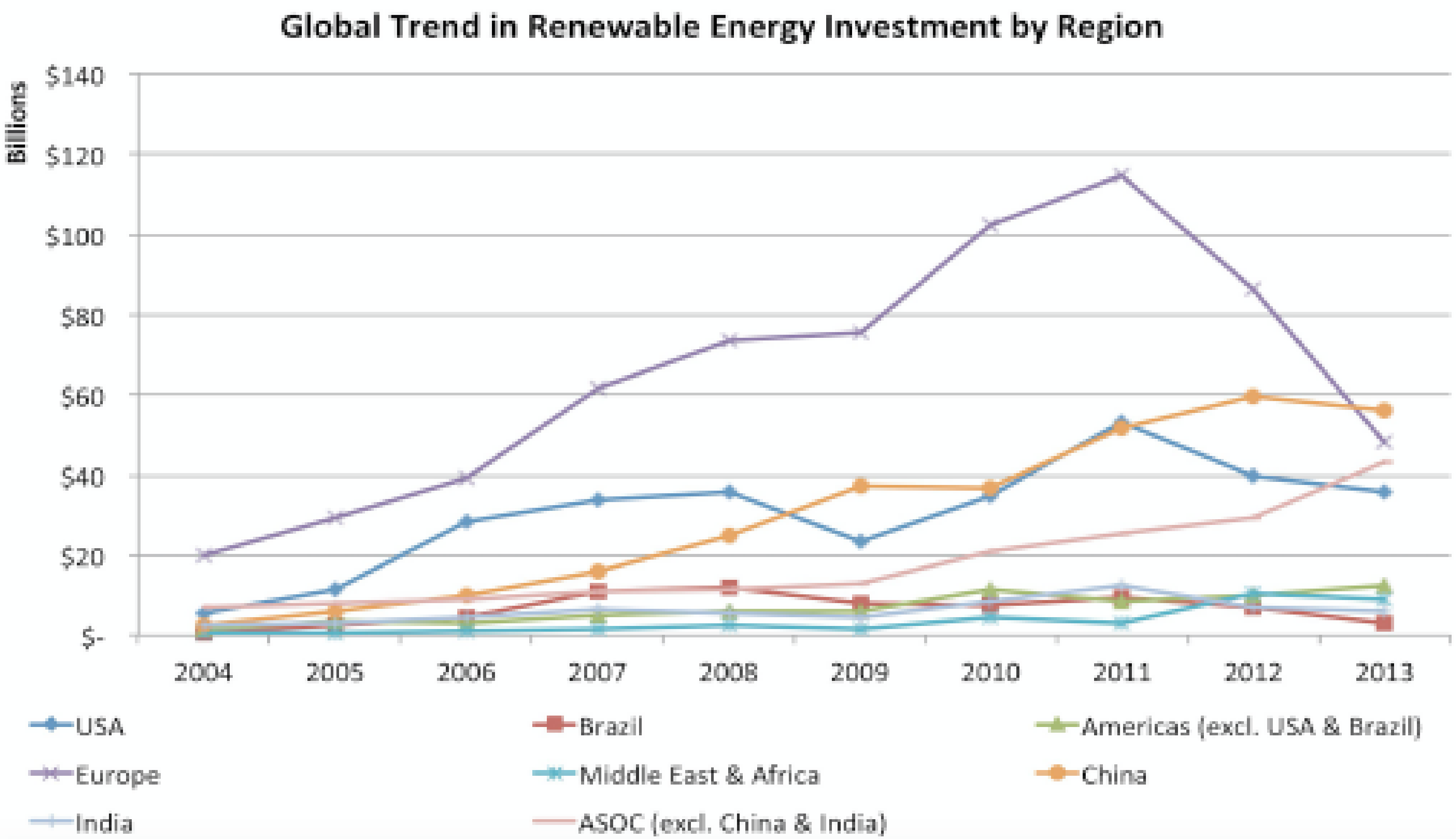


Change in public investment 2008-2015

Euro area (19)	-11%
Germany	24%
France	-4%
Italy	-23%
Spain	-48%

M. Mazzucato, *The Green Entrepreneurial State*, SPRU WP 2015

Fig. 2 (source: FS-UNEP/BNEF, 2014)



4 reasons for a new EU public investment policy

- **1. Macroeconomics**: could provide demand, ending the stagnation, reduce debt/GDP ratios
- **2. Structural**: adapt Europe's economic structure with rise of new, environmentally sustainable, knowledge intensive, high skill/wage activities,

a. **Environmental sustainability**

b. **Knowledge intensive applications of ICTs**

c. **Health and welfare services**

4 reasons

- **3. Cohesion**

  Inequality and social disparities could be reduced. Within the EU, centre-periphery divides (national and regional) could be limited.

- **4. Ecological sustainability**

  Reduce use of non renewable resources/energy, protecting ecological systems, lowering CO2/other emissions, reducing waste, recycle,

- ***Need for new EU policy and governance arrangements is this field***

1. The macroeconomic argument

Very large consensus:

- OECD, ***G20/OECD Draft Report on Investment strategies*** *– OECD Report to G20 finance ministers and central bank governors*, Paris 2015
- IMF World Economic Outlook 2014
- Summers
- Juncker Plan

IMF, World Economic Outlook, 2014

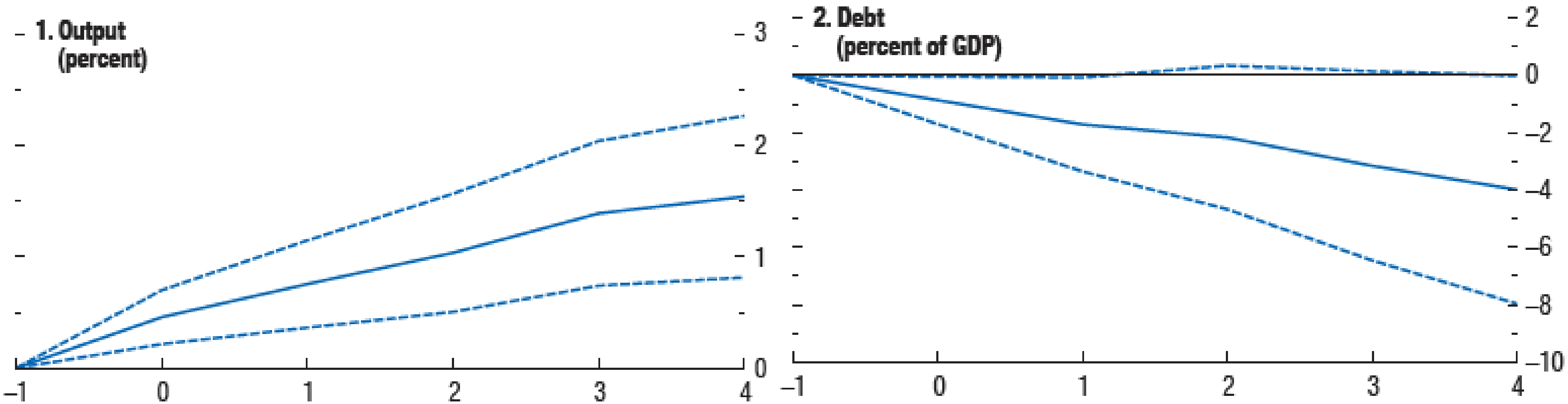
CHAPTER 3

IS IT TIME FOR AN INFRASTRUCTURE PUSH? THE MACROECONOMIC EFFECTS OF PUBLIC INVESTMENT

For economies with clearly identified infrastructure needs and efficient public investment processes and where there is economic slack and monetary accommodation, there is a strong case for increasing public infrastructure investment. Moreover, evidence from advanced economies suggests that an increase in public investment that is debt financed could have larger output effects than one that is budget neutral, with both options delivering similar declines in the public-debt-to-GDP ratio. This should not,

Figure 3.5. Effect of Public Investment in Advanced Economies
(Years on x-axis)

Public investment shocks have a statistically significant and long-lasting effect on output. They also typically reduce the debt-to-GDP ratio, though the decline in debt is statistically significant only in the short term. The level of private investment rises in tandem with GDP.



(Figure 3.6, panels 1 through 4).[19] During periods of low growth, a public investment spending shock increases the level of output by about 1½ percent in the same year and by 3 percent in the medium term,

IMF, 2014

- The **golden rule** excluding public investment from fiscal consolidation works

Improvements in fiscal institutions and some fiscal rules could help protect public investment during periods of fiscal consolidation.

Budget rules also affect public investment spending, especially in the case of the so-called golden rule of public finance. This rule calls for excluding net investment spending from the budget balance against which implicit or explicit fiscal discipline targets are applied.

US: Lawrence Summers, 2016

- “**There is a consensus that the US should substantially raise its level of infrastructure investment**. Economists and politicians of all persuasions recognise that this can create quality jobs and provide economic stimulus without posing the risks of easy-money policies in the short run”.
- “An increase in investment of **1% of GDP over a decade** would total $2,200 billion”

http://larrysummers.com/2016/09/12/building-the-case-for-greater-infrastructure-investment

- "Infrastructure investments pay for themselves by expanding the economy and increasing the tax base. The McKinsey Global Institute has estimated a 20% per cent rate of return. If it is only 6% and the government collects about 25 cents on every dollar of GDP, it will earn 1.5% on investments, more than the real cost of borrowing over a horizon of 30 years. **Debt financing of new infrastructure investment would be entirely reasonable"**.
- Government borrowing costs are much lower than the returns demanded by private-sector investors"

What has Europe done?
Assessing the Juncker investm plan

1. Bruegel

Assessing the Juncker Plan after one year,

by G. Claeys, A. Leandro, 17 may 2016

- **Little additionality, little novelty in the projects funded so far**
- "EFSI should only be used for really innovative and risky projects that cannot find funding at the moment because of market failures" EIB should increase its share of capital in the high risk projects and lower it in the others

2. Ofce

PROBABLY TOO LITTLE, CERTAINLY TOO LATE

AN ASSESSMENT OF THE JUNCKER INVESTMENT PLAN

M. LE MOIGNE, F. SARACENO, S.VILLEMOT

OFCE WP, March 2016

Simulation of the macroeconomic impact, using DSGE model

“We found that had the Juncker plan been implemented in a timely manner, it would have helped to significantly shorten the recession”.

“EU authorities should have implemented a much bolder plan. **As it is, the Juncker plan is likely not going to be effective at all**.”

2. The structural argument

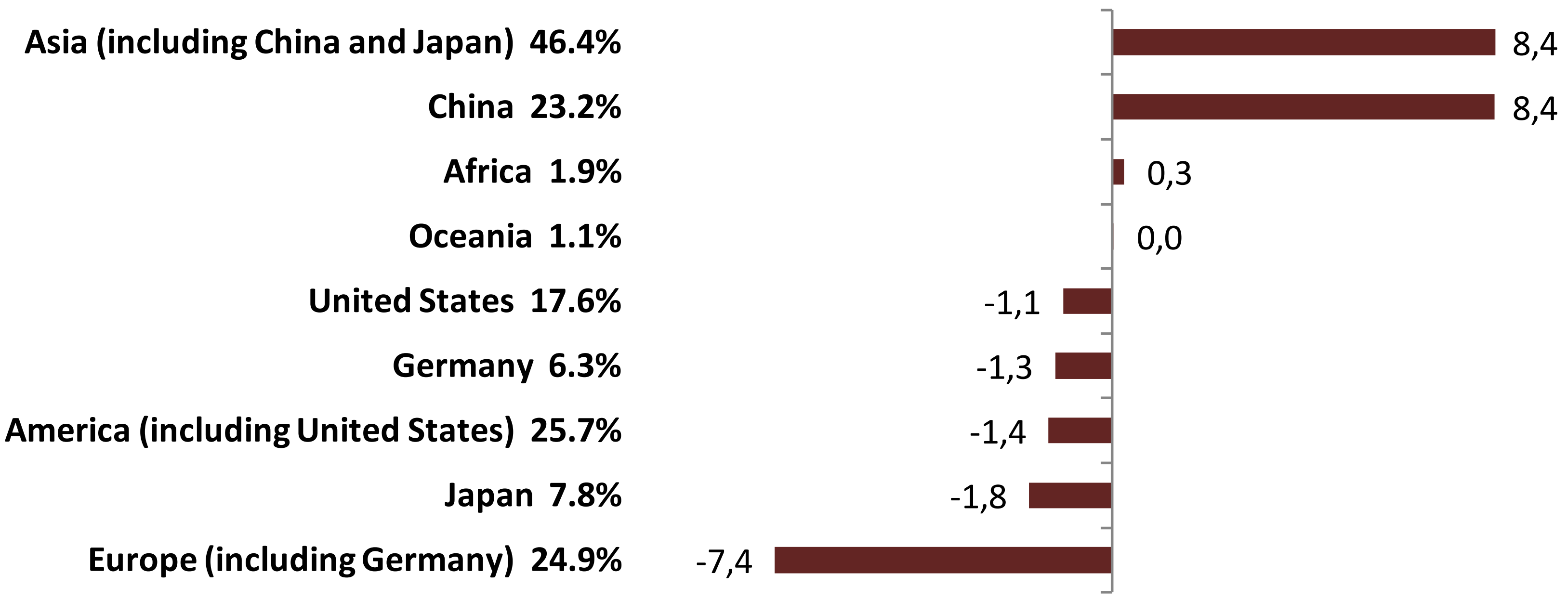
Intereconomics Forum, 50, 3, 2015

- **Which Industrial Policy Does Europe Need?**

  Mariana Mazzucato, Mario Cimoli, Giovanni Dosi, Joseph E. Stiglitz, Michael Landesmann, Mario Pianta, Rainer Walz, Tim Page

- **Divergence in economic activities, greater imbalances in balance of payments, greater instability and risks of disintegration**
- **A EU investment plan could address these risk**

Figure 1. World Manufacturing Value Added shares in 2013 and change in percentage points from 2008 to 2013.



Note: Annual data, US dollars at current prices and current exchange rates in millions.
Source: UNCTAD, Economic Trends, National accounts.

Employment change in North, South, Eastern Europe Upswing and Downswing

Annual rates of growth (2003-2008; 2008-2013)

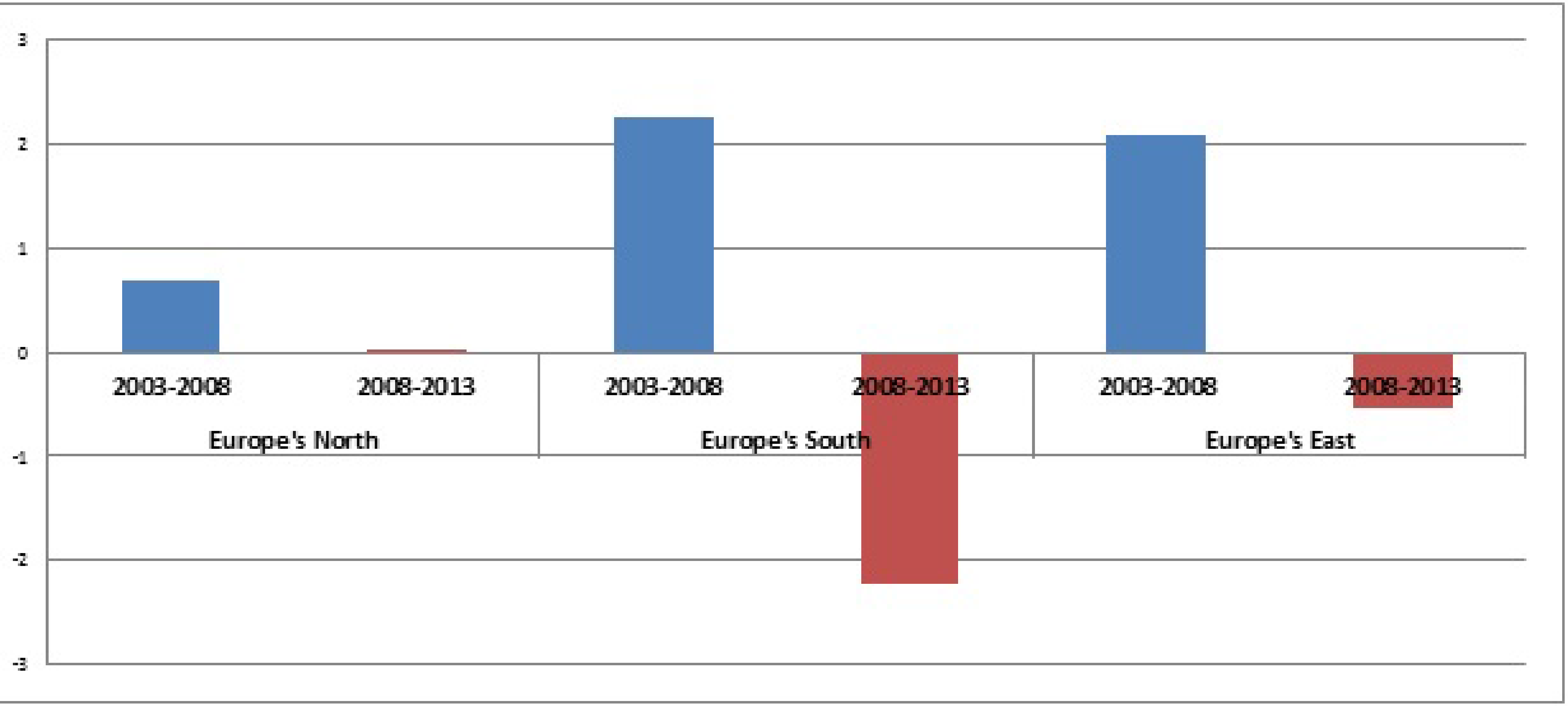
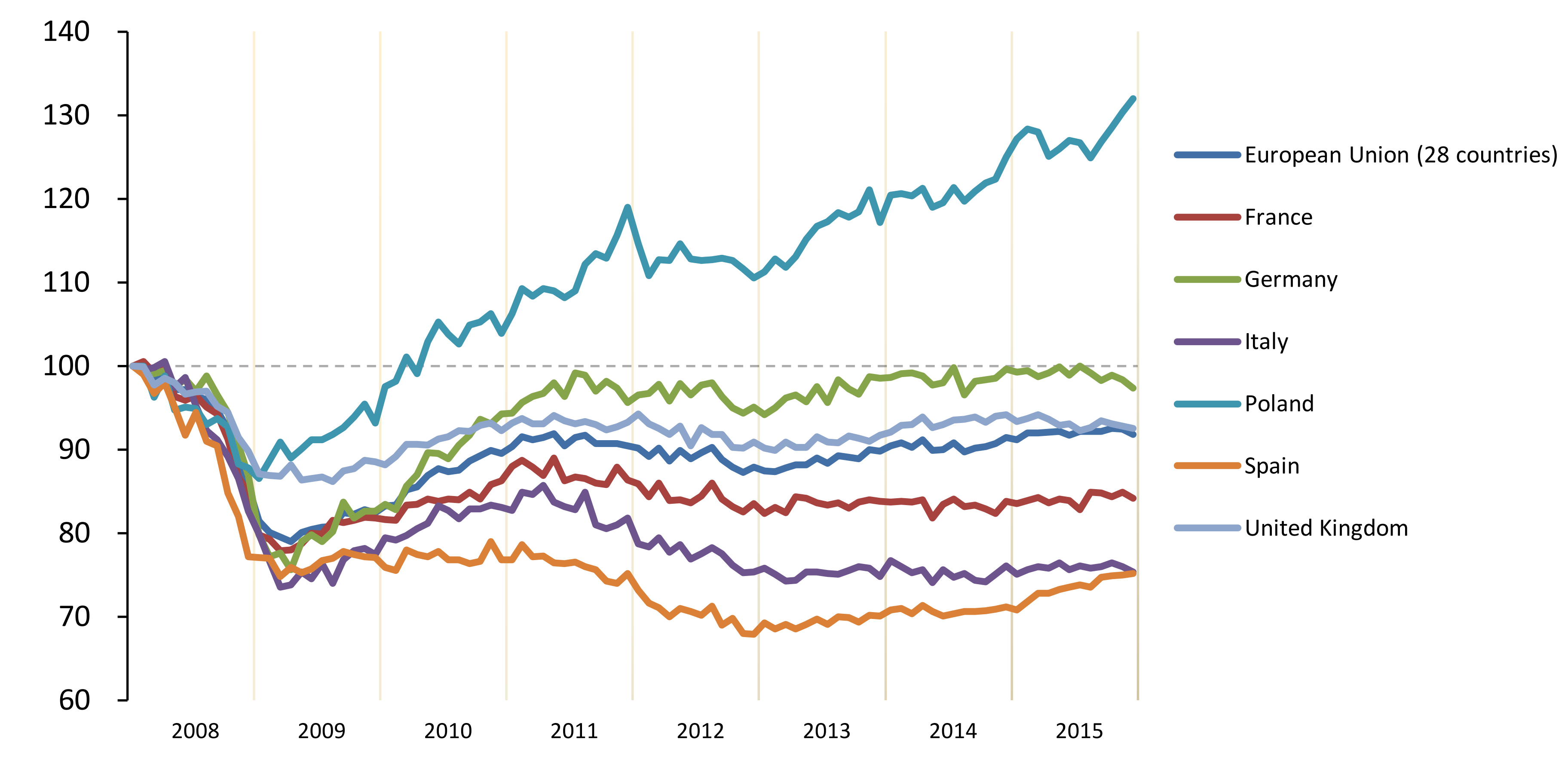


Figure 3. Index of production in manufacturing for EU28 and selected European economies, January 2008=100.

Monthly data, seasonally adjusted and adjusted by working days.



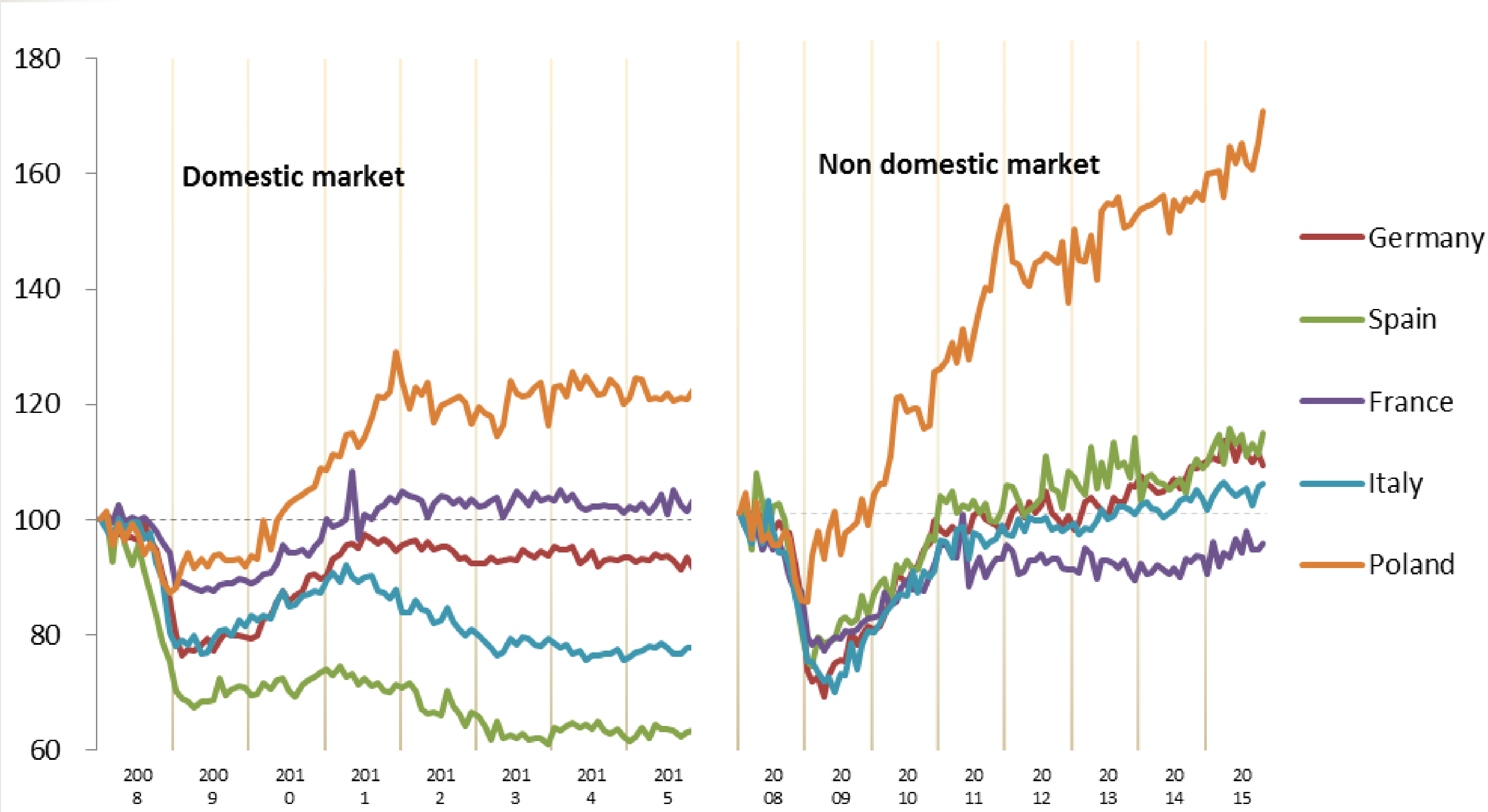
Source: Eurostat, Short-term business statistics, Industry.

Countries	**Industrial Production - Manufacturing (Nace C)** 2015 volume index of production (annual data) 2008 = 100	**Youth Unempl. rate (Less than 25 years)** Change in the % 2015-2008	**Youth Unempl. rate (Less than 25 years)** % in 2015
Germany	102	-3.1	7.3
Austria*	102	1.8	10.3
Netherlands*	100	2.7	12.7
Poland	134	3.7	20.9
Ireland	145	7.3	20.6
Denmark	99	2.6	10.6
Finland	80	5.9	22.4
Sweden	82	0.2	20.4
France	89	6.1	25.1
United Kingdom*	97	1.9	16.9
Italy*	79	21.5	42.7
Portugal	92	10.4	32
Spain	80	23.8	48.3
Greece*	74	30.5	52.4

*2014

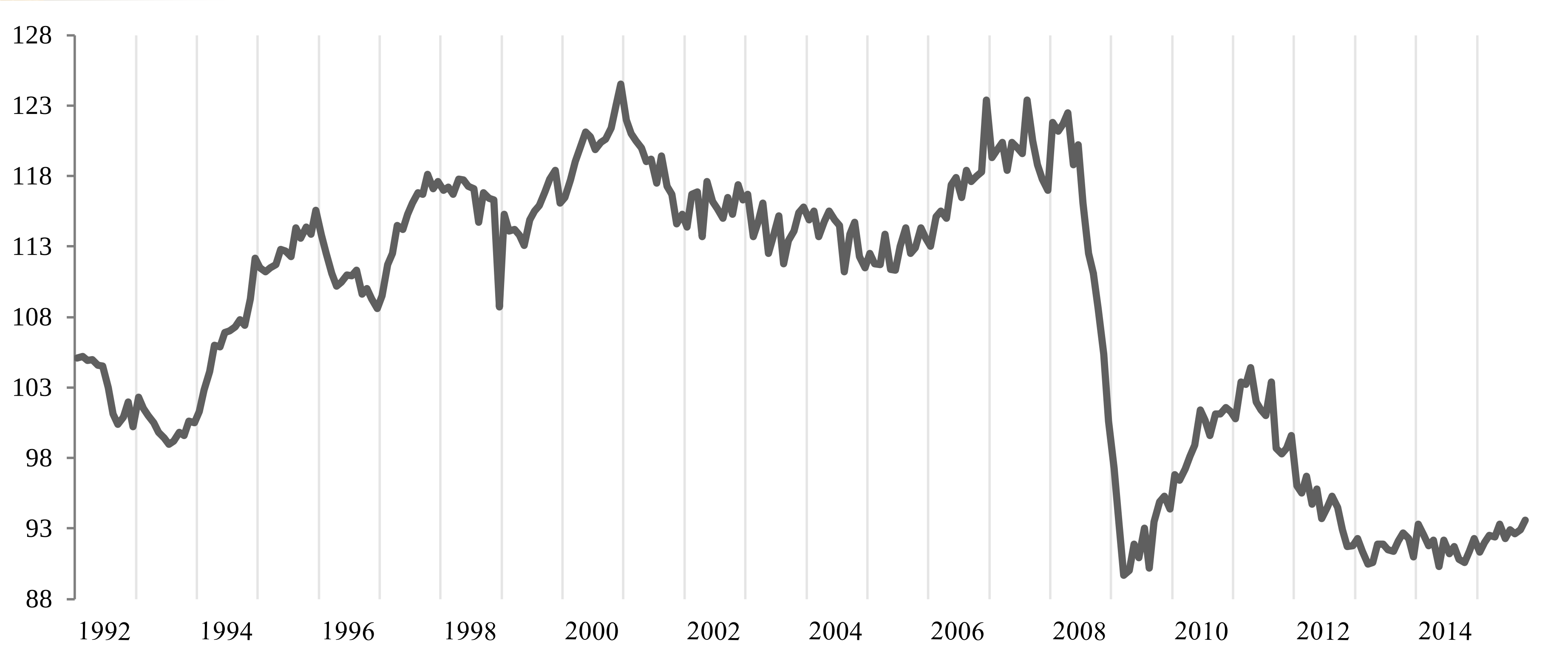
Figure 4. Total turnover in manufacturing (domestic and non domestic market) for selected European economies, January 2008=100.

Monthly data, seasonally adjusted and adjusted by working days.



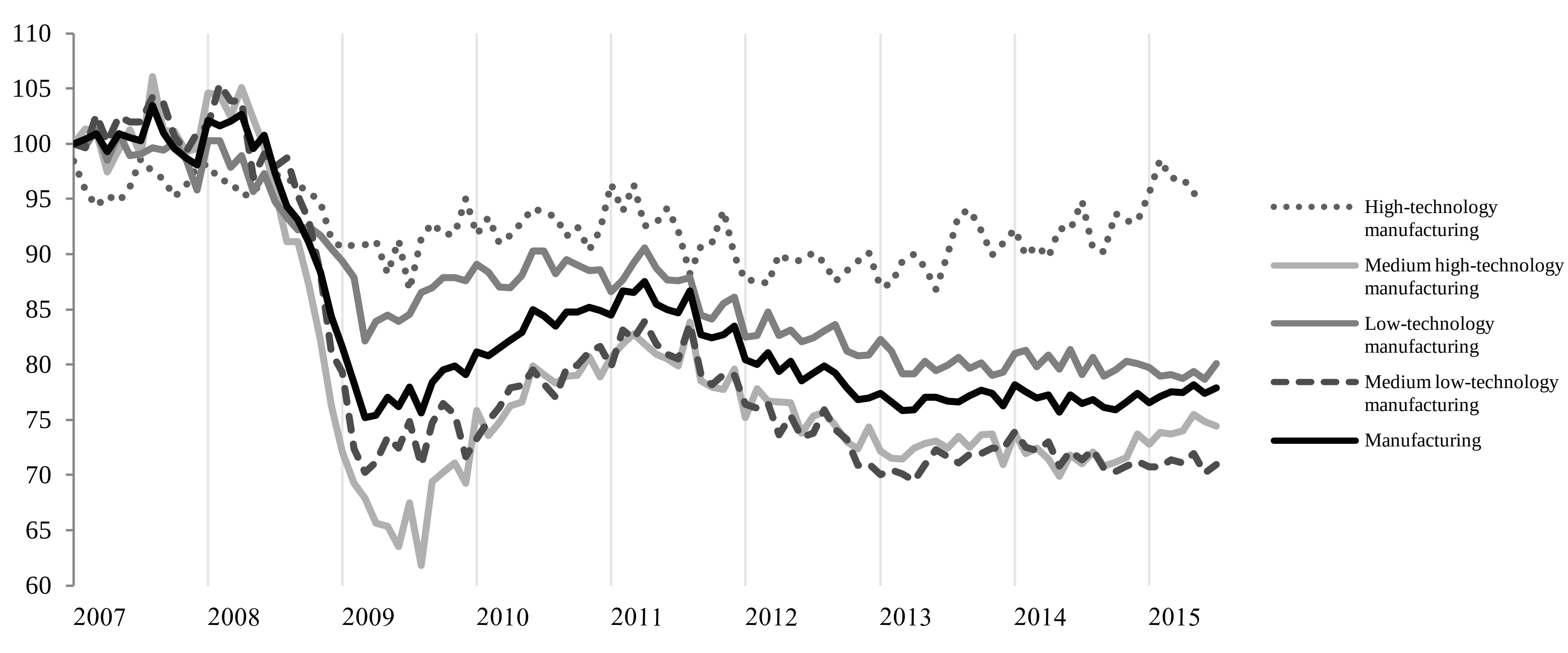
Source: Eurostat, Short-term business statistics, Industry.

Figure 1. Italy's production in industry, volume index of production
Monthly data, seasonally adjusted and adjusted by working days, 2010=100



Fonte: Istat, Indagine sulla Produzione Industriale (release October 2015).

Figure 3. Italy's production in industry, volume index of production by technology
Monthly data, seasonally adjusted and adjusted by working days, 2007=100



Fonte: Eurostat, Short-term business statistics, Industry.

3. The cohesion argument

The crisis and austerity policies have worsened:

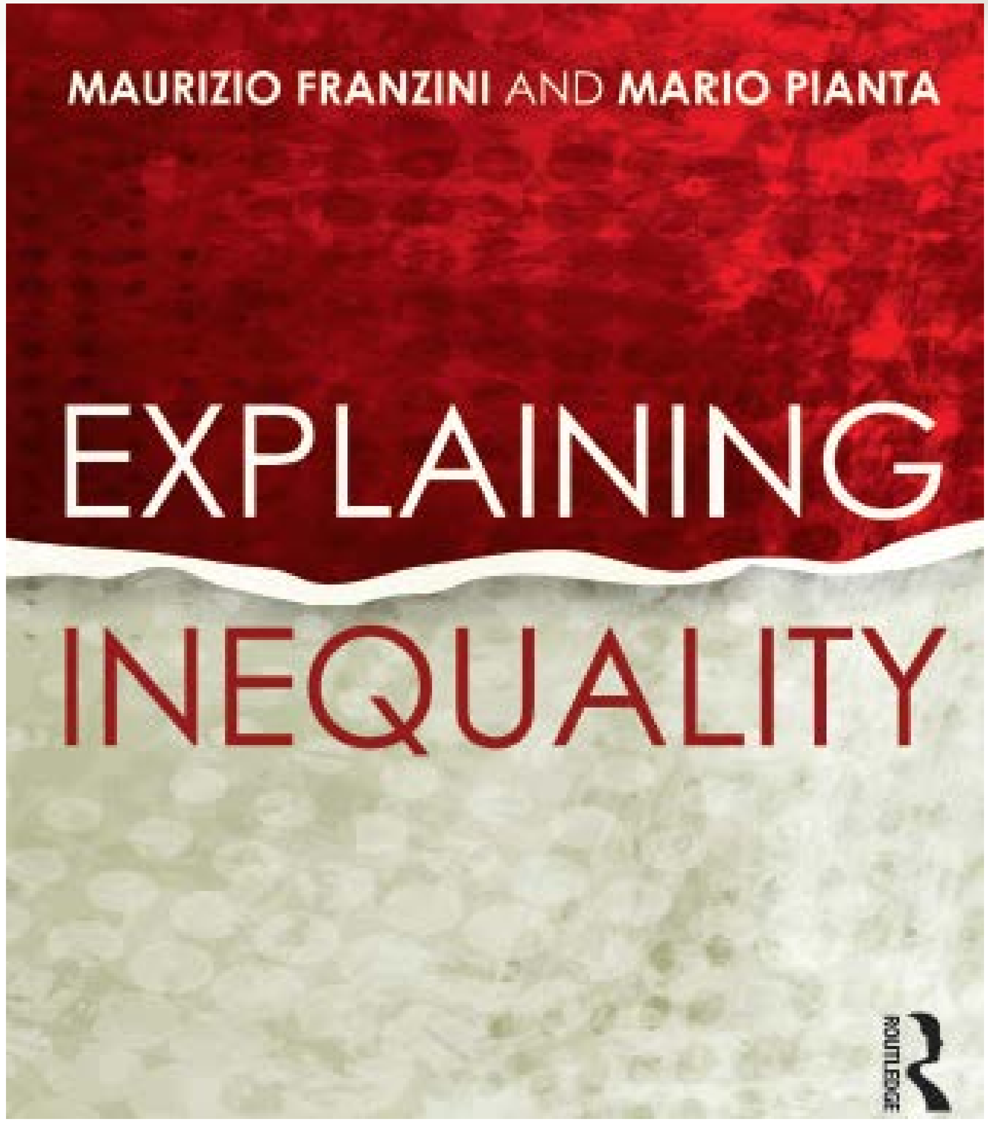
- **Divergence among EU countries**

(GDP, but also R&D, education, EU2020 goals)

- **Social disparities and income inequality**

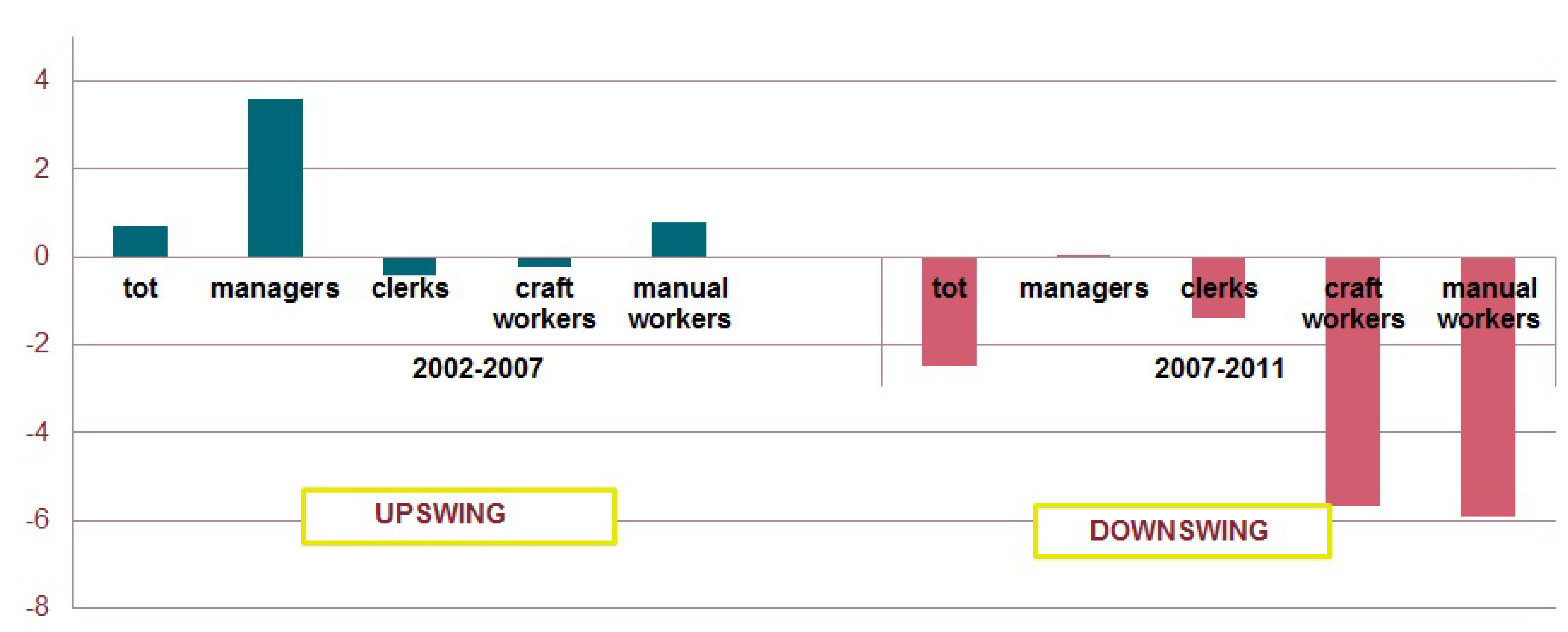
(asymmetric fall in jobs and incomes, impact of provatisations of public services, new intra-EU migrations, less social mobility)

Socially (and environmentally) oriented public investment could reverse these trends


MAURIZIO FRANZINI AND MARIO PIANTA
EXPLAINING
INEQUALITY
ROUTLEDGE

Employment by professional groups

Average annual growth rate. Percentage change (DE, FR, IT, ES, UK)



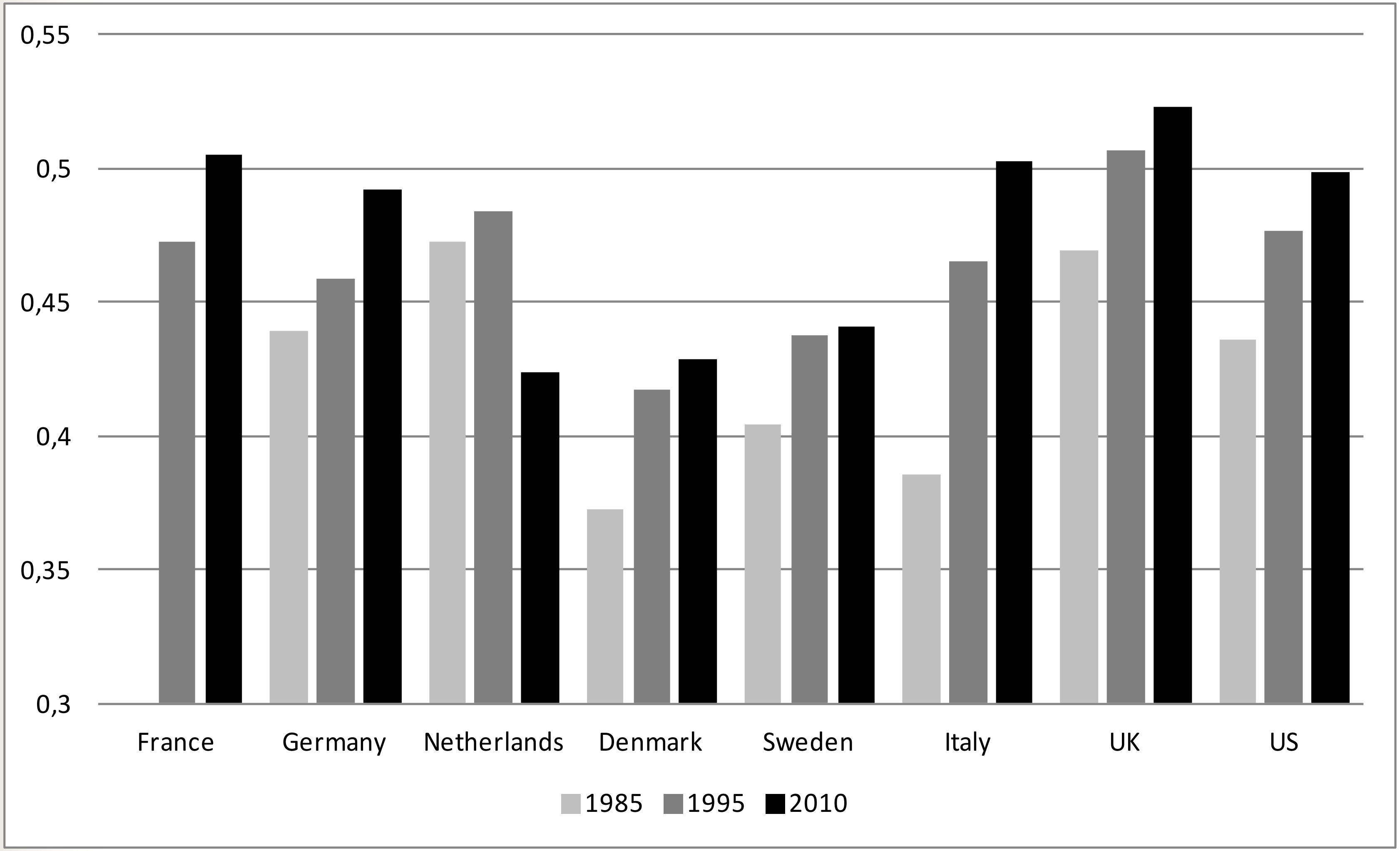
Expansions are polarising, mostly in services

Contractions are reducing polarisation mostly in manufacturing due to huge losses of lowest skills.

Gini index of inequality in household market incomes, 1985-2010

Gini index on equivalised household market incomes.

Calculations on OECD data, http://www.oecd.org/social/income-distribution-database.htm



What does Europe already do?

- Europe2020
- Structural Funds and cohesion policy
- *Flagship initiative* “An integrated industrial policy for the globalisation era”, ‘Smart specialisations’
- Environmental actions and the Energy Union
- the European Investment Bank
- The European Fund for Strategic Investment and EIF
- Policies for attracting foreign investment

Juncker Plan

- **Industrial compact** and **Juncker Plan** start to acknowledge these problems
- No real EU priority and resources available
- 2 bn for **Juncker Plan** (should be 8bn + EIB + nat'l sources, then all turned into 315 bn)
- 1,300 projects costing a total of 2,000 billion: Potential and need for investment

Europe’s industrial policy

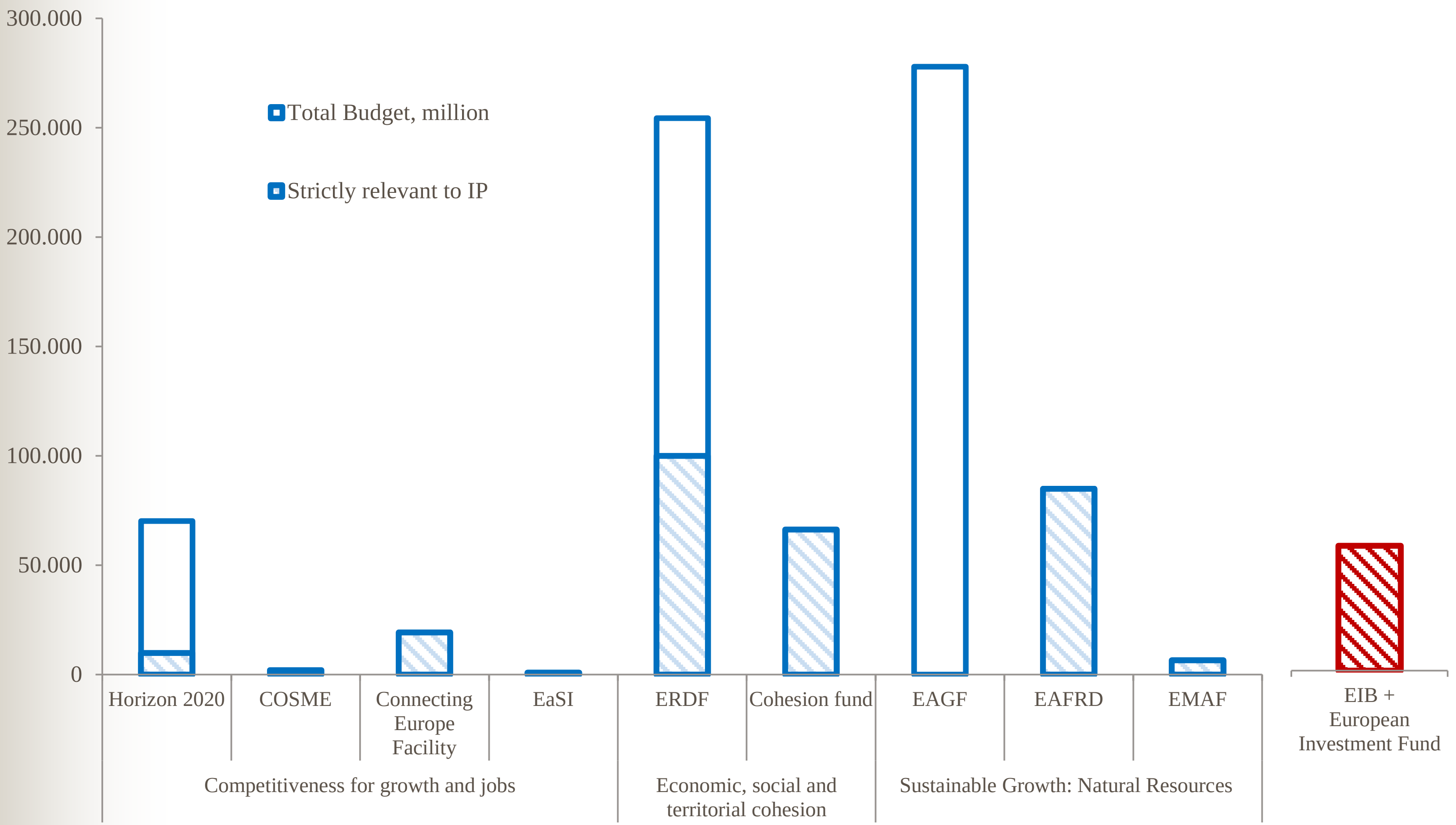


Figure 7. A summary of current main industrial policy actions in the EU

European Union *Europe 2020 goals*	Anti-trust, Free trade	Smart Special. Ind. Compact	Structural Funds	EIB	Regulation
Decisions imposed on countries	Intern. and ext. liberalisation. TTIP negotiat. protecting priv. investm.	Buil. critical mass of focused adv. activities Goal of 20% of GDP from industry No additional EU funds	Infrastuct., education, support for regional dev., spec.,cohesion: 0.4% of EU GDP	Funds for profitable investm. € 72 bn	Specific rules for industries, environm. etc.
Fund EU activities	***EU prevents Natl. action***	***EU rules***	***EU rules Natl. co-financing***	***Financial mkt logic***	***EU rules prevail***
Natl. Governments	State Ent. Procurem.	"Old" ind. pol.	Horizontal pol.	Public Invest.	Natl. Regul.
			R&D tax credits Infrastr., educat. regional pol. (little funds, little effects)	Major cuts in public investm. projects	Major probl. in food, environ., GMOs, media, culture, etc.

What the EU could do: a public investment plan

- Europe-wide investment plan
- **2% of Europe’s GDP (about EUR 260 billion) for a decade**
- greater national policy space with a ‘golden rule’ for public investment.
- reduce the divergence between Europe’s centre and periphery, concentrate resources in weaker regions and weaker countries.

Funds

- Role for the ECB
- Long-term, high-risk public capital is needed to fund investment financial markets avoid
- Role of EIB

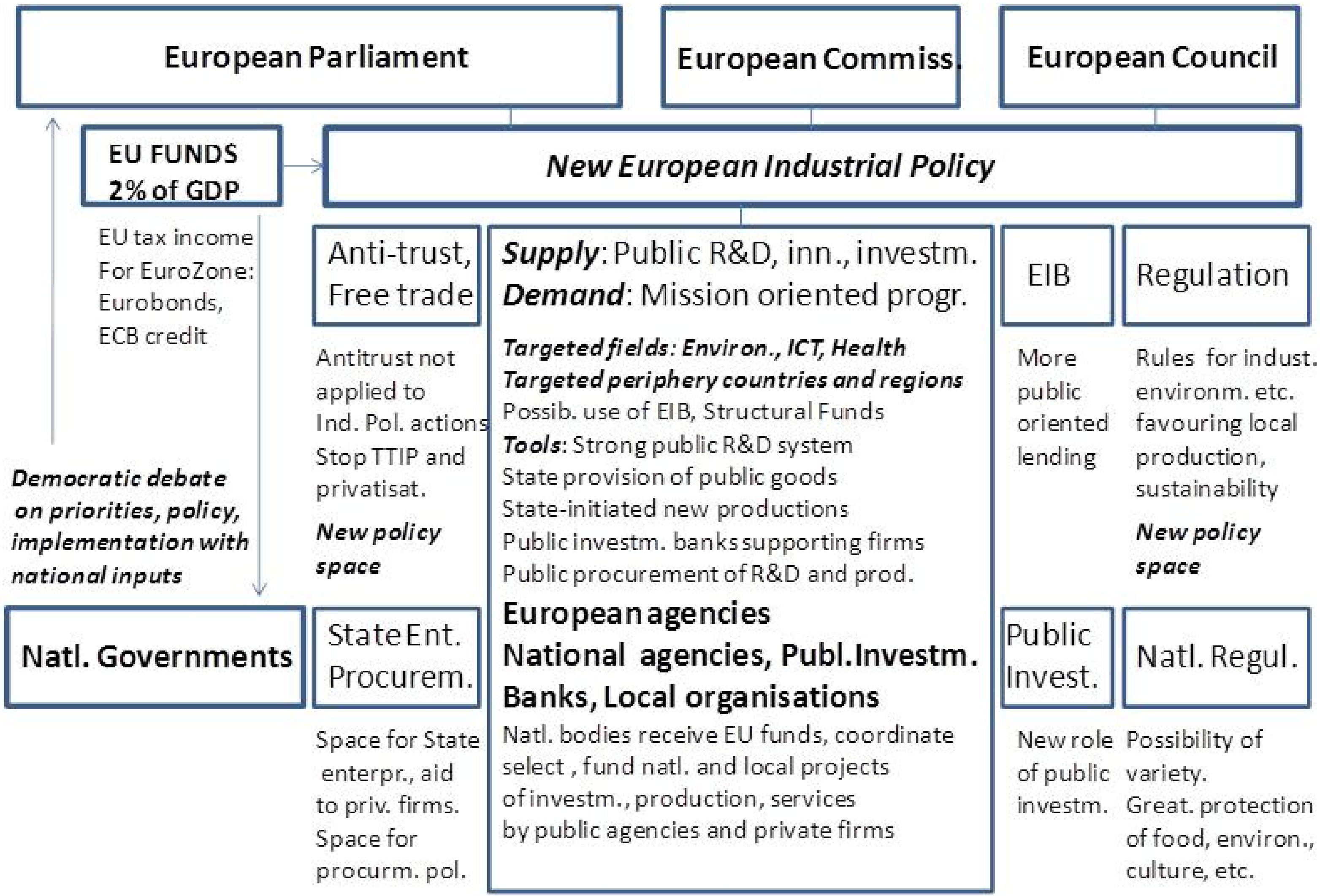
Key fields to be targeted

- environmental sustainability;
- appropriate ICT applications;
- health and public services

(coherent with EU2020)

- innovative and efficient new economic activities employing high-skill, high-wage labour
- no focus on manufacturing alone, no focus on whole industries

Figure 8. A summary of the new European industrial policy proposed



Tools

- Greater general support for R&D, education, horizontal actions
- Public investment programmes,
- Public procurement
- public enterprises,
- support of private firms,
- mission-oriented innovation programmes
- Link to environmental and other policies

Implementation

- Implemented at the national and regional levels, with bottom-up efforts and democratic processes
- Reinventing the governance of public-interest economic activities, political and social consensus
- Need for new arrangements for the governance of public interest economic activities,
- Transparency, monitoring, avoid collusion, corruption, waste

Papers on investment plans and industrial policy

- Pianta, 2014, An industrial policy for Europe. **Seoul Journal of Economics**, 27, 3, 2014.
- Lucchese, Nascia, Pianta, Industrial policy and technology in Italy, Special issue, **Economia e Politica Industriale,** 43, 3, 2016
- Pianta, Lucchese, Nascia, **What is to be produced? The making of a new industrial policy in Europe.** RLS report 2016