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Armin Steinbach

Towards a European Recovery Programme for the Crisis Countries

Austerity measures alone will not suffice to generate the growth needed for recovery in Greece, Portugal, Spain and Italy. A European Recovery Programme is necessary to stimulate growth through structural reforms and fiscal stimulus. This contribution describes policy areas where non-fiscal instruments are required to boost growth and identifies fields where public and private expenditures can generate significant positive spillovers for the economy or pave the way for new growth potentials.

Calls for a Marshall Plan or recovery programmes are in vogue. The downturn in the real economy in southern European countries has led to the perception that austerity alone cannot bring back growth to these countries; instead, there is hope that a European Recovery Programme (ERP) could lead to new growth impulses and help to carry out the structural reforms necessary for new growth. Recently, the European Commission has attempted to foster some growth impulses in Greece: a lower co-financing requirement for EU regional funds, greater flexibility in allowing the redirection of resources to accelerate spending in areas with more growth potential and the setup of a task force to prioritise infrastructure projects.

There remains significant vagueness as to how an ERP would look, in particular concerning instruments and fiscal volume.¹ This paper provides a concept of the kind of fiscal stimulus that could help the real economy get back on its feet and increase the competitiveness of Southern European countries in the long run. The analysis is structured as follows. The next section describes the size of a potential European Recovery Fund (ERF) and examines its fiscal effectiveness depending on its volume and the number of countries benefiting from the ERF. The paper then identifies the fields where competitiveness in the Southern euro countries is comparatively low and proposes measures to

increase the competitiveness of the overall economy. This includes structural measures as well as fiscal instruments.

Volume and Possible Beneficiaries of the ERF

Beside necessary structural reforms, the first requirement for an effective investment programme is an adequate volume. The financial means of the EU Structural Funds amount to only 0.4% of the GDP of the EU27; consequently, many commentators consider the Funds to be ineffective.² From a historical perspective, the Marshall Plan grants were provided at a pace that amounted to nearly three per cent of the combined national incomes of the recipient countries between 1948 and 1951.³ The yearly impact of these grants on national growth from 1948 until 1951 was estimated at 0.5%.

What is the volume potentially available for an ERF? We argue that the ERF should have at least three components: the remaining funds not yet disbursed through the EU Structural Fund; the revenue generated by a Financial Transaction Tax (FTT) beginning in July 2013, as proposed by the European Commission, amounting to €55 billion per year; and a €10 billion increase in the paid-in subscribed capital of the European Investment Bank (EIB), which could induce annual private investments of €10 billion per year as from 2013, implying an eightfold leverage effect.

1 See also B. Marzinotto: A European Fund for Economic Revival in Crisis Countries, Bruegel Policy Brief, Issue 2011/01; IMF: Fostering Growth in Europe Now, IMF Staff Discussion Note, 18 June 2012, p. 9.

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2 M. Boldrin, F. Canova: Europe's Regions: Income Disparities and Regional Policies, in: Economic Policy, Vol. 16, No. 32, 2001, pp. 207-253.

3 B. Eichengreen, B. De Long: The Marshall Plan: History's Most Successful Structural Adjustment Program, October 1991, p. 30.

Table 1
Current Spending Status of EU Cohesion Funds and Future Financial Means

| | Pre-allocated Structural and Cohesion Funds and Macro-financial assistance, 2007-2013 (in € billions) | Disbursed by end of 2011 (in % of pre-allocation) | Unallocated sums by end of 2011 (in % of pre-allocation) | Undisbursed amount for 2012-2013 (allocated or unallocated, in € billions) | Undisbursed amount for 2012-2013 (allocated or unallocated, in % of annual GDP, 2010) | Unallocated amount for 2012-2013 (in € billions) | Additional investment credit in 2013 through increase of EIB's paid-in subscribed capital by €10 billion (in € millions) | Structural and Cohesion Funds for 2014-2020 (Structural funds, innovation, employment, in € billions) | Additional investment credit in 2014-2020 through increase of EIB's paid-in subscribed capital by €10 billion (in € millions) |
|----------|---|---|--|--|---|--|--|---|---|
| Greece | 20.42 | 34.94 | 21 | 13.29 | 2.89 | 4.29 | 586 | 31.65 | 4,103 |
| Spain | 35.22 | 36.52 | 31 | 22.36 | 1.05 | 10.92 | 1,011 | 54.58 | 7,075 |
| Portugal | 21.51 | 37.77 | 14 | 13.39 | 3.87 | 3.01 | 617 | 33.34 | 4,322 |
| Italy | 28.81 | 37.77 | 29 | 17.93 | 0.58 | 8.36 | 827 | 44.65 | 5,789 |
| EU27 | 348.42 | 33.36 | 24 | 232.19 | 0.95 | 82.00 | 10,000 | 540.00 | 70,000 |

Source: Own calculations based on data from European Commission.

First, there are considerable amounts not yet being disbursed (though mostly allocated to projects already). At the beginning of 2012, the average payment rate for all three EU Structural Funds was 33.4% of the amounts allocated for the 2007-2013 period. The payment rates vary significantly between 16.5% and 48.3%. For Greece, the remaining undisbursed means for 2012-2013 equal 2.89% of Greek GDP. By contrast, at the EU27 level the remaining undisbursed funds amount to only 0.95% of EU GDP (see Table 1).

Putting the remaining assets of the EU Structural Funds, the revenue from an FTT and the extra lending capacity of the EIB (as from 2013) together would create a volume of €299 billion – equivalent to a rather small 1.22% of annual GDP in the EU27 for the period 2012-2013. Spending the money solely in the Southern EU4 (Greece, Portugal, Spain, Italy) instead would equal a stimulus of 2.11%, and focusing the ERF only on the EU2 (Greece, Portugal) would yield a stimulus of 10.53% of GDP. These amounts do not include additional amounts from the co-financing nature of the EU Structural Funds and the use of financial instruments leveraging private capital like project bonds.⁴ A significant share of the EU Structural Funds has been allocated to specific projects, but there are remaining means which have not yet been allocated to specific programmes totalling more than €25 billion in the EU4 (see Table 2).

4 According to the Commission's "Project Bonds Initiative", private sector investment could be induced by public guarantees, yielding €4.6 billion of private investment for only €230 million of public means.

For the period 2014-2020, the European Commission has tabled a proposal in which Structural and Cohesion Funds and other means for employment and innovation amount to €540 billion.⁵ In combination with annual revenue of €57 billion, this would create a volume of €1,009 billion or 1.17% of the annual GDP of the EU27 for that period. Spending the money in the Southern EU4, it would equal a stimulus of 2.77% of GDP, and focusing the ERF only on the EU2 would create an annual stimulus of 16.75% of GDP.⁶

In sum, at least for the short-term period 2012-2013, the volume of the ERF should be focused on the EU4, because, first, these countries are facing the most urgent need for reform and the worst growth forecasts in

5 The Commission assigns €376 billion for the cohesion policy, €80 billion for research and innovation and €84 billion for social matters.

6 For these calculations, each country's share of Structural Fund means is presumed to be the same as in the period 2007-2013.

Table 2
Potential Volume of European Recovery Fund Depending on Beneficiary

| | EU27 | | EU4 | | EU2 | |
|-----------|-----------|--------------------|-----------|--------------------|-----------|--------------------|
| | € billion | in % of annual GDP | € billion | in % of annual GDP | € billion | in % of annual GDP |
| 2012-2013 | 299.185 | 1.22 | 126.998 | 2.11 | 84.875 | 10.53 |
| 2014-2020 | 1,009 | 1.17 | 584.511 | 2.77 | 472.411 | 16.75 |

Source: Own calculations based on data from European Commission.

the eurozone for 2012. Second, the ERF would be too small for effective fiscal impulses at the EU27 level, and finally, other EU members will retain the funds already allocated to them through the EU Structural Funds.

Instruments for an Investment Programme

The ERP should clearly not be understood as a pure fiscal investment programme to pour money into crisis countries, thereby creating moral hazard. Indeed, Ederveen et al. find that EU funds become effective only when accompanied by an appropriate institutional framework.⁷ Thus, the ERP must contain non-fiscal reform measures aimed at enhancing competitiveness. ERF payments should be conditional upon measures creating an adequate business environment, establishing rule of law and reforming labour and product markets. Conditionality of the ERP ensures the proper implementation of non-fiscal reforms.

We propose eight guidelines for implementing an investment programme. The idea of pursuing an active industrial policy, which is inherent in this programme, is in line with recent contributions that find evidence of the effectiveness of government intervention, suggesting a case for active industrial policy.⁸

Increasing Labour Market Efficiency

Labour market efficiency and flexibility are critical. Ideally, labour markets have the flexibility to shift workers from one economic activity to another rapidly and to allow for wage fluctuations without much social disruption.

The situation in the EU4 presents a mixed picture. A common feature is the bad performance of the relationship between pay and productivity (see Table 3), reflecting a significant increase in unit labour costs over the last decade. Not surprisingly, there is a positive correlation between unit labour costs and current account deficits. Wage moderation will thus be a key for these economies to regain competitiveness. Also, young unemployed workers and women could particularly benefit from labour market flexibilisation. In Spain, Greece and Italy, current levels of employment rigidity are relatively high and hiring and firing practices are

Table 3
Labour Market Efficiency: EU17 Ranking

| | Pay and productivity | Rigidity of employment | Hiring and firing practice | Redundancy costs, weeks of salary | Women in labour force |
|----------|----------------------|------------------------|----------------------------|-----------------------------------|-----------------------|
| Greece | 15 | 16 | 10 | 8 | 16 |
| Spain | 17 | 10 | 16 | 14 | 15 |
| Portugal | 14 | 7 | 17 | 17 | 5 |
| Italy | 16 | 15 | 9 | 6 | 17 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010-2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

impeded by regulations (see Table 3). Moreover, those three countries have the lowest female participation rate in the EU17 and few part-time opportunities. There is an empirical correlation between these two figures (see Figure 1). Thus, more part-time and temporary contract opportunities could increase participation rates and lower unemployment (see Figure 2).

Empirical studies show that unemployment benefits, employment protection and collective bargaining explain some of the difference in labour market performance.⁹ In particular, studies in Europe find that high employment restriction, longer and more generous unemployment benefits, high tax wedges and collective bargaining systems that are more favourable to wages than employment affect employment and productivity adversely.¹⁰

In terms of implementing country-specific measures to address these problems, there is good practice experience with national agreements between worker unions, employers and governments. In the 1990s, Greece, Portugal and Italy successfully adopted such “competitiveness agreements” at the national level. These agreements aimed at fulfilling the Maastricht criteria and sought to allow wage developments and bargaining structures to increase competitiveness and lower inflation. Building on this experience, bargaining partners and governments should jointly analyse and propose country-specific measures that could make labour market conditions more competitive.

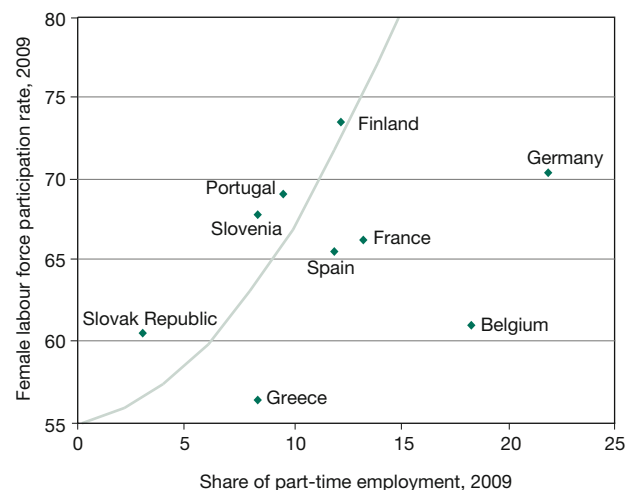
7 S. Ederveen, H.L.F. Groot, R. Nahuis: Fertile Soil for Structural Funds? A Panel Data Analysis of the Conditional Effectiveness of European Cohesion Policy, in: *Kyklos*, Vol. 59, No. 1, pp. 17-42, 02, Blackwell Publishing, 2006.

8 P. Aghion, J. Boulanger, E. Cohen: Rethinking industrial policy, Bruegel Policy Brief, Issue 2011/04.

9 Mourre: Did the Pattern of Aggregate Employment Growth Change in the Euro Area in the Late 1990s?, in: *Applied Economics*, Vol. 38, 2006, pp. 1783.

10 IMF, op. cit.

Figure 1
Link Between Female Employment and Part-time Employment



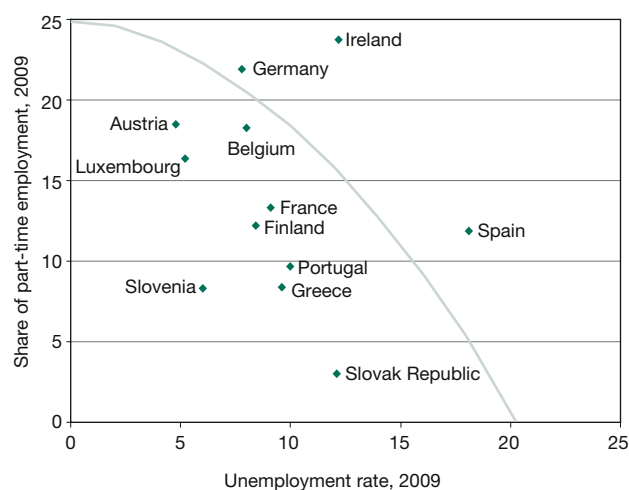
Source: Own calculations based on OECD Employment Outlook (2011).

Since 2010, the EU4 have indeed made progress in labour market reforms. In Greece, entry-exit costs to the labour market have been reduced and firm-level bargaining has been promoted. Also, the minimum wage was reduced by 22% and frozen for the next three years. In Italy, social partners signed agreements in 2011 to promote wage decentralisation and to allow firm-level contracts to derogate from national contracts. In Portugal, legal provisions to allow for the more flexible use of working time arrangements are going to be reformed. In Spain, the labour reform of February 2012 seeks to ease the use of fair dismissals with low severance costs for firms in economic distress and gives priority to firm-level agreements over collective agreements.

However, continuous efforts should focus on further increasing firms' internal flexibility and decentralising wage bargaining. Raising wage flexibility would make it possible to reduce unit labour costs, particularly in less productive job segments. Generally, a reduction of tax wedges on labour income should be sought by shifting taxation toward indirect taxes. However, there is a significant time lag and a risk of adverse short-term effects from labour market reforms. The reforms are likely to produce positive employment effects in the long run but can tend to increase unemployment in the short run.¹¹ Labour market reforms in the Southern European

11 L. Bernal-Verdugo, D. Furceri, D. Guillaume: Labor Market Flexibility and Unemployment: New Empirical Evidence of Static and Dynamic Effects, in: Comparative Economic Studies, Vol. 54, No. 2, 2012, pp. 251-273.

Figure 2
Link Between Unemployment and Part-time Employment



Source: Own calculations based on OECD Employment Outlook (2011).

countries would thus need to be complemented by policies that stimulate aggregate demand. In the absence of large fiscal potentials due to budget restraints in the Southern countries, short-run growth would depend on more domestic (ideally private) demand in the Northern countries and sound monetary policy.¹²

Improving Qualification of the Labour Force

Highly alarming are the youth unemployment rates in the EU4, which are the highest in Europe, ranging between 31% in Italy and 48% in Spain. The reasons for this development are country-specific and hard to generalise. In Italy, several factors played a role, such as labour market segmentation and an unbalanced unemployment support system which created inter-generational inequalities. Spain suffers from a very high level of early school leavers, which adversely impacts the ability of the labour force to match the demand for certain skills.

However, there are indicators that point to generally underperforming educational systems as a common weakness. In terms of basic education, the EU4 rank among the lowest in the eurozone, with Spain in last place among the EU17 (see Table 4). Basic education is essential, as workers who have received little formal education can carry out only simple manual work and find it much more difficult to adapt to more advanced

12 IMF, op. cit., p. 18.

Table 4
Qualification: EU17 Ranking

| | Quality of primary education | Tertiary education enrolment | Quality of educational system | Extent of staff training | Quality of math and science education |
|----------|------------------------------|------------------------------|-------------------------------|--------------------------|---------------------------------------|
| Greece | 16 | 1 | 17 | 16 | 13 |
| Spain | 17 | 3 | 16 | 15 | 17 |
| Portugal | 15 | 7 | 14 | 14 | 16 |
| Italy | 13 | 4 | 15 | 17 | 15 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010–2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

production processes and techniques. Lack of basic education can therefore become a constraint on business development, with firms finding it difficult to move up the value chain by producing more sophisticated or value-intensive products.

Higher education and training is crucial for economies that want to move up the value chain beyond simple production processes and products. In particular, today's globalising economy requires countries to nurture pools of well-educated workers. Interestingly, the EU4 rank among the highest in terms of tertiary enrolment, but the overall quality of their educational systems is very low, indicating that tertiary education in these countries does not meet labour market standards (see Table 4). Also, the extent of staff training is very low in the EU4, indicating a failure to appreciate the importance of vocational and continuous on-the-job training.

Hence, solutions have to address different situations in these countries. In the short term, quick support for training to match labour market demand is essential. To encourage private sector hiring, wage subsidies could be an instrument. In Austria, companies that employ young unemployed people receive 50% of their salary from the state for the first three months. In the medium term, instruments to improve school education should be applied, including professional training, education of professors, and equipment for schools and kindergartens.

In some countries, the implementation of “second chance” schools has proved an effective instrument to foster the integration of youth who failed to graduate. Instruments to improve the quality of tertiary education may include more apprenticeships and traineeships via EU programmes like Erasmus and Leonardo da Vinci,

Table 5
Business Sophistication: EU17 Ranking

| | State of cluster development | Value chain breadth | Production process sophistication | Nature of competitive advantage |
|----------|------------------------------|---------------------|-----------------------------------|---------------------------------|
| Greece | 17 | 17 | 17 | 16 |
| Spain | 11 | 12 | 12 | 12 |
| Portugal | 12 | 13 | 15 | 15 |
| Italy | 1 | 6 | 11 | 3 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010–2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

the introduction of specialised university courses for sectors of particular potential in the country concerned (e.g. in the fields of tourism, aquaculture or agriculture in Greece) or compulsory internships at a foreign university in the penultimate university year.

Enhancing Business Sophistication

Generally, sophisticated business practices are conducive to higher efficiency in the production of goods and services. The quality of a country's overall business networks and the quality of individual firms' operations and strategies depend on the degree of business sophistication.¹³ Of particular importance are clusters, the geographically proximate groups of interconnected companies and associated institutions. In clusters, efficiency is heightened, greater opportunities for innovation in processes are created and barriers to entry for new firms are reduced. Regional clusters linking industrial production, universities, service suppliers and research institutions initiate new value chains and can be drivers for innovation and growth.

In terms of business sophistication, there are significant differences within the EU4. While Italy has deep and well-developed clusters, Greece's performance in this area is inadequate (see Table 5). The lack of collaboration between academia and private business in Greece hinders employment, innovation and entrepreneurship.¹⁴ Similarly, the value chain breadth rankings underscore that Greece largely relies on low-cost and labour-intensive processes, while Italy exhibits a high

¹³ World Economic Forum: Global Competitiveness Report 2010-2011, p. 8.

¹⁴ McKinsey: Greece 10 years ahead, November 2011, Exhibit 20.

degree of sophistication with unique products and technologies.

The rankings for production process sophistication indicate the minor presence of exporting companies in the value chains (e.g. resource extraction or production) in Greece and Portugal. In turn, there are almost no export activities across the entire value chain covering product design, marketing sales, logistics and after-sales services.

The identification of clusters – both regionally and based on value chains – could offer a path forward. Regulatory privileges should be granted, including fiscal privileges (e.g. improved allowances for the depreciation of investments), rapid permission and authorisation procedures, and additional investment bonuses from the EU structural funds. There are also significant linkages to educational and vocational qualification. The more the educational systems can increase the high-skill labour force, the higher will be the benefits to innovation-oriented production processes. Finally, incentives for regional clustering of research institutions could lead to higher know-how spillovers between research and businesses.

Efficient Institutions and a Sound Business Environment

The quality of institutions has a strong impact on competitiveness and growth.¹⁵ Economic growth and investments require a sound business environment and swift public administration based on the rule of law. However, the role of institutions goes beyond the legal framework. Government attitudes toward markets and freedoms as well as the efficiency of its operations are also very important: excessive bureaucracy and red tape, overregulation, corruption, dishonesty in dealing with public contracts, lack of transparency and trustworthiness, and the political dependence of the judicial system impose significant economic costs to businesses and slow the process of economic development.¹⁶

The EU4 countries rank the lowest among EU17 countries concerning public sector administration (see Table 6). For example, Italy, Greece and Portugal perform badly regarding private business compliance with governmental administrative requirements (e.g. permits,

¹⁵ D. Rodrik, F. Rodriguez: Trade Policy and Growth: A Skeptic's Guide to Cross-National Evidence, NBER Working Paper No. 7081, Cambridge, MA 1999.

¹⁶ World Economic Forum, op. cit., p. 4.

Table 6
Administration Institutions: EU17 Ranking

| | Burden of government regulation | Transparency of government policymaking | Ethical behaviour of firms | Investor protection | Numbers of procedures to start a business |
|----------|---------------------------------|---|----------------------------|---------------------|---|
| Greece | 16 | 14 | 17 | 17 | 17 |
| Spain | 12 | 15 | 13 | 13 | 16 |
| Portugal | 15 | 16 | 14 | 7 | 12 |
| Italy | 17 | 17 | 15 | 10 | 9 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010–2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

regulations, reporting). The burden of regulation in these countries is perceived as the highest in the EU17. Also, the lack of transparency of government policymaking reflects the difficulty for businesses to obtain information about changes in government policies and regulations affecting their activities. Further, there is a significant degree of tax evasion, such as informal labour activities where income taxes and social contributions are not collected. Finally, the business environment is influenced by the ease of launching a new business. Greece and Spain perform particularly poorly on this measurement.

In addition, a high degree of fragmentation and an overlap of responsibilities among public authorities create burdens and delays to business operations. For example, in Greece there are 13 ministries involved in 27 tourism-related activities.¹⁷ Reducing inefficiency does not require a reduction of public sector employees in all these countries. In Greece, public sector employment lies well above the EU27 average, while public sector employment in the other three countries is below the EU average.

There has been progress in the last few years in the EU4. Greece passed legislation to improve the business environment by simplifying the process to start up a business as well as licensing and judicial procedures. Also, legislation was adopted to liberalise restricted professions, transportation services and energy. Similarly, Italy introduced reforms to accelerate administrative simplification. Portugal has revised its competition framework and adopted a new corporate insolvency law.

¹⁷ McKinsey, op. cit., p. 20.

Table 7
Financial Market Development: EU17 Ranking

| | Ease of access to loans | Venture capital availability | Legal rights index |
|----------|-------------------------|------------------------------|--------------------|
| Greece | 15 | 17 | 15 |
| Spain | 13 | 12 | 13 |
| Portugal | 12 | 13 | 17 |
| Italy | 16 | 16 | 16 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010–2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

Further measures taken to improve business environments include projects dedicated to investigating possible informalities in different fields of economic activities, faster authorisation procedures based on e-government initiatives and “one-stop shops”, the adoption of uniform practices and monitoring of public procurement, and the break up of professional monopolies – especially in services sectors (e.g. taxi drivers, lawyers, pharmacists) – to increase transparency and access to such professions.

Although economic literature has focused mainly on public institutions, private institutions are also an important element in the process of wealth creation. Corporate ethics (ethical behaviour in interactions with public officials, politicians and other enterprises) of firms are very low in the four countries. Private sector transparency is indispensable to business and can be brought about through the use of standards as well as auditing and accounting practices.¹⁸

Promoting Financial Market Development

The recent financial crisis has highlighted the central role of a sound and well-functioning financial sector for economic activities. Economies require sophisticated financial markets that can make capital available for private sector investment from such sources as loans from a sound banking sector, properly regulated securities exchanges, venture capital and other financial products. The importance of such access to capital was recently underscored by the liquidity crunch experienced by businesses and the public sector. Also, funds tend not to flow to new investment opportunities, which is critical for structural reforms to pay off.

¹⁸ E.M. Gramlich: Infrastructure Investment: A Review Essay, in: Journal of Economic Literature, Vol. 32, No. 3, pp. 1176-1196, 1994.

Table 8
Technology and Innovation: EU17 Ranking

| | Availability of latest technologies | Firm-level technology absorption | FDI and technology transfer | Quality of scientific research institutions | Company spending on R&D | University-industry collaboration in R&D |
|----------|-------------------------------------|----------------------------------|-----------------------------|---|-------------------------|--|
| Greece | 16 | 16 | 15 | 17 | 17 | 17 |
| Spain | 12 | 13 | 12 | 13 | 14 | 12 |
| Portugal | 7 | 9 | 6 | 9 | 13 | 9 |
| Italy | 17 | 17 | 16 | 15 | 11 | 16 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010–2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

In the EU4, financial market readiness for business needs seems to be underperforming. Access to loans is rather difficult to obtain and entrepreneurs with innovative but risky projects have problems finding venture capital. Also, the degree of legal protection of borrowers and lenders' rights ranks very low in all four countries. Therefore, the availability of financial means from the EIB and the EU Structural Fund plays an even more important role in these countries: the EIB's Risk Sharing Finance Facility (RSFF) should be expanded to improve access to debt financing for private companies; special focus should be given to export credit facilities in order to enhance the export capacities of the EU4; the availability of the EU's venture capital facility should aim at strengthening the equity base of high-technology SMEs; and the EU Competitiveness and Innovation Framework Programme (CIP) supporting the competitiveness and eco-innovation of SMEs should be extended. At the EU level, measures to ensure well-functioning credit markets are key to growth. Funding costs for banks in the EU4 remain high, which impacts lending rates. Ongoing banking regulation needs to carefully calibrate banking deleveraging, taking into account the effect on the availability of loan facilities to the real economy. In particular, consideration should be given to facilitating access to credit by new emerging sectors, e.g. through partially underwriting credit risk.¹⁹

Promoting Innovation

Technological and innovation readiness is a measure of the agility with which an economy adopts existing technologies to enhance the productivity of its industries.

¹⁹ IMF, op. cit., p. 24.

Table 9
Infrastructure: EU17 Ranking

| | Quality of overall infrastructure | Quality of roads | Quality of railway infrastructure | Quality of air transport infrastructure |
|----------|-----------------------------------|------------------|-----------------------------------|---|
| Greece | 14 | 15 | 17 | 13 |
| Spain | 9 | 9 | 13 | 11 |
| Portugal | 6 | 4 | 9 | 14 |
| Italy | 17 | 14 | 15 | 17 |

Source: Own calculations based on World Economic Forum, The Global Competitiveness Report, 2010–2011; European Commission, Member States competitiveness performance and policies: Reinforcing competitiveness, 2011.

Competitive firms must design and develop cutting-edge products and processes to maintain a competitive edge. This requires an environment conducive to innovative activity, supported by both the public and the private sectors. In particular, it means sufficient investment in research and development (R&D), especially by the private sector; the presence of high quality scientific research institutions; and extensive collaboration in research between universities and industry.

There is a mixed picture on technology and innovation readiness in the EU4 (see Table 8). Portugal performs remarkably well, with a mid-range ranking in the eurozone on nearly all indicators. By contrast, businesses in Italy and Greece show very little ability to absorb new technologies or use new technologies. Also, there is little foreign direct investment bringing new technologies to the country. In Greece, the research environment is particularly bad. There are large deficits in scientific research institutions, and company spending on R&D is very low. In Greece and Italy, R&D collaboration between the business world and universities is very low, which not only results in a very low number of patents in these countries²⁰ but is also responsible for the poor placement of young university graduates in the workforce.

The ERF should be used for a significant increase in R&D expenditures. For example, the envisaged EU research programme Horizon 2020 should have a sizeable volume aimed at increasing the share of R&D to ten per cent of the overall EU budget. National fiscal regimes should incentivise R&D expenditures at the national level by, for example, allowing tax credits for business R&D expenditures (already in place in Portugal and Spain) using the fund. Furthermore, public pro-

²⁰ McKinsey, op. cit., Exhibit 20.

urement (which accounts for 17% of EU GDP) should be used more to push for the availability of the latest technologies.

Enhancing Infrastructures

Extensive and efficient infrastructure is critical for ensuring the effective functioning of the economy, as it is an important factor determining the location of economic activity and the kinds of activities or sectors that can develop in a particular economy. The quality and breadth of infrastructure networks significantly impact economic growth and affect income inequalities and poverty in a variety of ways.²¹ Effective modes of transport, including quality roads, railways, ports and air transport, enable entrepreneurs to get their goods and services to market in a secure and timely manner and facilitate the movement of workers to the most suitable jobs.

Quality of infrastructure differs widely among the EU4 (see Table 9). Portugal appears to provide general infrastructure (e.g. transport, telephony and energy) that is relatively good as well as high quality roads, while being ranked less favourably regarding air transport infrastructure. Similarly, Spain has decent overall and road infrastructure. By contrast, despite significant expenditures on infrastructure modernisation, Italy and Greece underperform in all infrastructure categories. There have been recent efforts by the EU to accelerate the identification and permitting procedures of infrastructure projects.

Funding of infrastructure projects can be an effective instrument to increase the competitiveness of economies across sectors. Thus, a priority scheme for the four countries should be set up which would allow fast-track procedures for the construction of the most needed infrastructure. National permitting procedures have to be shortened. Where infrastructure is built by private business, the use of “project bonds” as proposed by the Commission could ensure the investment grade of private investment. The “Connecting Europe” facility of the EU should provide more than the €50 billion currently envisaged in the next EU budget to put greater focus on infrastructure needs in the EU4.

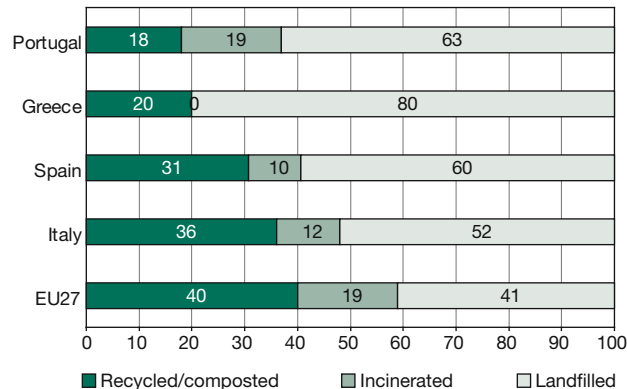
Resource and Energy Efficiency

Efficiency of resources is key for all competitive economies. There is a great potential for energy efficiency

²¹ World Economic Forum, op. cit., p. 4.

Figure 3
Share of Total Municipal Solid Waste by Method of Management

in %



Source: Eurostat Structural Indicators.

gains in the EU4. All of them are characterised by high energy consumption given the output of the industrial sector in comparison to, for example, Germany. The differences are primarily driven by differences in the mix of the industrial activity and their energy intensity. Energy efficiency is particularly low in Greece, where electricity consumption in the residential and commercial segments is up to 40% higher and fuel consumption for transportation up to 10% higher than in other Southern European markets.²²

Exploitation of energy efficiency potentials requires both public and private upfront investments and effective incentive schemes to accelerate implementation. Such incentive schemes could foresee specifications for energy efficient buildings and strict auditing procedures and penalties. Subsidies or tax rebates as incentives could be paid out of the ERF. Pursuing an energy efficiency programme for buildings would require the adjustment of relevant standards and could generate positive spillovers for the construction industry. Demand-side management in electricity and gas consumption should be enabled through the implementation of “smart grid” technologies. Pilot projects for innovative technologies (e.g. smart meters) should be financed through the fund. Finally, the geographic potential of renewable energy should be exploited. The efficient allocation of renewable energy production requires a uniform system of subsidisation (e.g. feed-in tariffs). This should provide Southern EU countries a comparative advantage.

²² McKinsey, op. cit., p. 43.

Another field with a large potential for resource efficiency is waste management. All EU4 countries rely on landfills as the primary way to manage waste; in Greece, 80% of total municipal waste goes to landfills versus just 41% in the EU (see Figure 3). Greece is the only country in the EU not using incineration as a method of waste management. Moving away from land-filling and introducing higher added value waste management methods (incineration, recycling, composting) can have significant environmental and financial benefits for the country and is becoming an imperative driven by EU Directives. Like other EU countries, the EU4 could increase the rate of recycling and incineration and recover more energy from waste. Also, investments in technology-intensive recycling technologies could make sense.

Conclusions

Austerity measures alone will not suffice to generate the growth needed for recovery in the crisis countries. Notwithstanding some doubts as to whether earlier fiscal recovery programmes have been effective, there is a need for structural reforms in a wide range of policy areas in these countries. While non-fiscal instruments are required to boost growth in some policy areas (e.g. labour markets, public administration), there are fields where public and private expenditures can generate significant positive spillovers for the economy (e.g. research and development, qualification) or pave the way for new growth potentials (e.g. resource efficiency, infrastructure).

As to the funding of the measures, the ERF should place at least a short-run emphasis on the EU4 in order to ensure a sufficiently high volume of fiscal stimulus. Clearly, the proposed structural reforms materialise predominantly in the medium term. Only active labour market policies and tax reforms are likely to generate a short-term impact, mainly because they entail fiscal effects. Reforms of labour and product markets are mostly achieved in the long run.²³ Given the limited short-term effect of structural reforms, supportive macroeconomic policies need to be adopted, including accommodative monetary policy, a restructuring and recapitalisation of the banking sector, and fiscal consolidation which avoids procyclicality.

²³ IMF, op. cit., p. 15.