

# WIFO

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## **A New Strategy for Europe** **Reaping the benefits of change**

**Karl Aiginger**

**4<sup>th</sup> Austrian Investor and Business Conference**  
**New York City, April 13<sup>th</sup>, 2016**

- 
- **Europe: Status 2016**
  - **The new **strategy**: benchmark, 3 principles, 7 drivers**
    - **Developed by 34 teams, at request of EU-Commission**
    - **Kenneth Arrow, Barry Eichengreen, Jeff Sachs on board**
  - **The **hidden potential** of Europe**
  - **Lessons for and learning from **Austria****
  - **Summary**

**Annex: data, graphs, documents, figures.**

## A success model in a difficult stage

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- **Indicators of the long run success**
  - From 6 to 28 (+), largest economic area
  - From trade agreement to common market and currency
  - Peace, soft power, spreading "rule of law" (© Jeffrey Sachs)
- **Strengths of Europe:**
  - Rising median incomes, high life expectancy
  - Rather stable world market share, export surplus
  - Manufacturing, energy efficiency, renewables
  - Integration machine (w.r.t. Eastern Europe: © World Bank).

# Challenges and weaknesses call for a new strategy

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## ■ Challenges

- Globalization, ageing, heterogeneity, new technologies
- Climate change, political instability, refugees, polarization

## ■ Weakness signs

- Lost decade, unemployment, R&D gap, poverty
- Governance, Euro crisis, imbalances, exit parties, BREXIT
- “not in a good state” (Junker, 2015); “broken system”

⇒ **New long run strategy** commissioned to 33 teams

⇒ **Karl Aiginger: NEW DYNAMICS FOR EUROPE:**

REAPING THE BENEFITS OF SOCIO-ECOLOGICAL TRANSITION (<http://Synthesis-Summary.foreurope.eu>).

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# WIFO ■ The WWWforEurope vision in a nutshell

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## ■ Europe as role model for **successful** regions 2050:

- Stronger **dynamics** based on innovation and human capital
- **Less differences** in incomes, higher employment
- World leader in environmental **technology, energy efficiency**
- Heterogeneous **preferences, pluralistic policy approach**
- Open area, **enjoying globalization**; inviting neighbours

⇒ **A genuine European model of wellbeing**

⇒ **Deepening existing strengths**

⇒ **Not copying US or Asian models.**

## High and rising wellbeing

- This benchmark substitutes GDP and GDP growth
- Theoretical underpinning: Beyond GDP concept
  - Stiglitz – Sen – Fitoussi Commission 2009
- Operationalisation
  - Three strategic goals
  - With several objectives within each goal
  - Measurable by Better life indicators OECD, EU.

# WIFO ■ The three strategic goals for wellbeing

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- **Simultaneity** between goals and instruments
    - Instead of silo strategies
    - The latter are expensive and inefficient
  - **High-Road-Strategy**
    - Forfeiting low costs and standards (“low.cost competitiveness”)
    - Based on capabilities, ambitions (USP of excellent firms)
  - **Two-stage strategy**
    - First stage: Consolidation and reprogramming
    - Second stage: Socio-ecological transition: given low growth
- First stage not business as usual but**  
**investment in change: decarbonisation, skill upgrade.**

- 
- **Innovation**: boosting and **redirecting**
  - **Dynamics**: reducing **inequality**, investment in change
  - **Welfare**: from protection to **social investment**
  - **Employment**: **symmetric** flexibility + upgrading skills
  - **Energy**: decoupling and **decarbonisation**
  - **Public sector**: halving **taxes on labour**
  - **Finance**: recommitting to **real economy** & **societal** needs.

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## Why it should **work this time**:

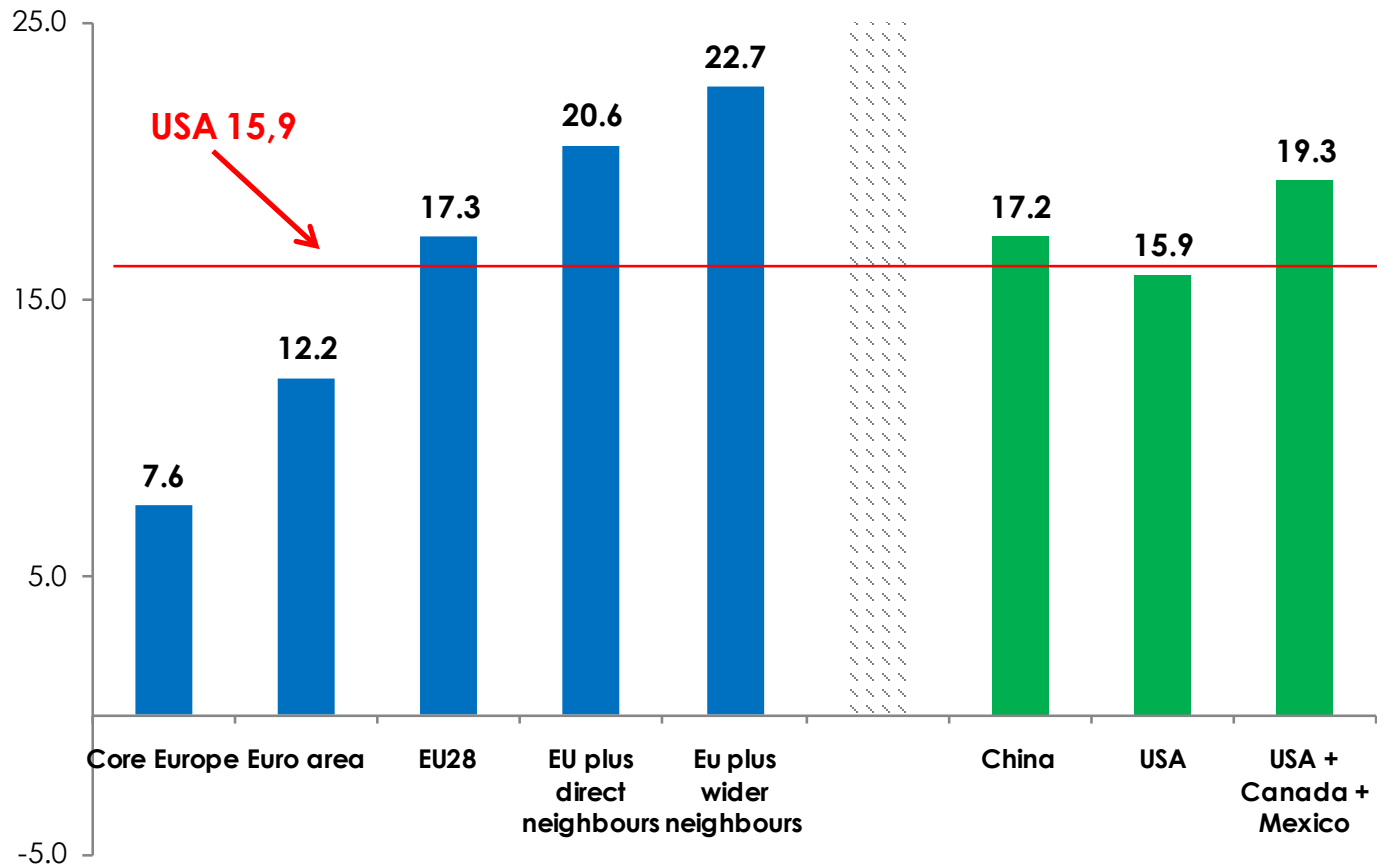
- Going for compromises, **not corner** solutions
- **Bundling reforms**, partial compensation, **fairness**
- Taking business, social **partners**, NGO's on board
- **Inviting youth**, migrants, new actors
- Monitoring progress by **indicators** ("nowcasting" GDP)

⇒ **Necessity of change is understood**

⇒ **Potential for excellence exists.**

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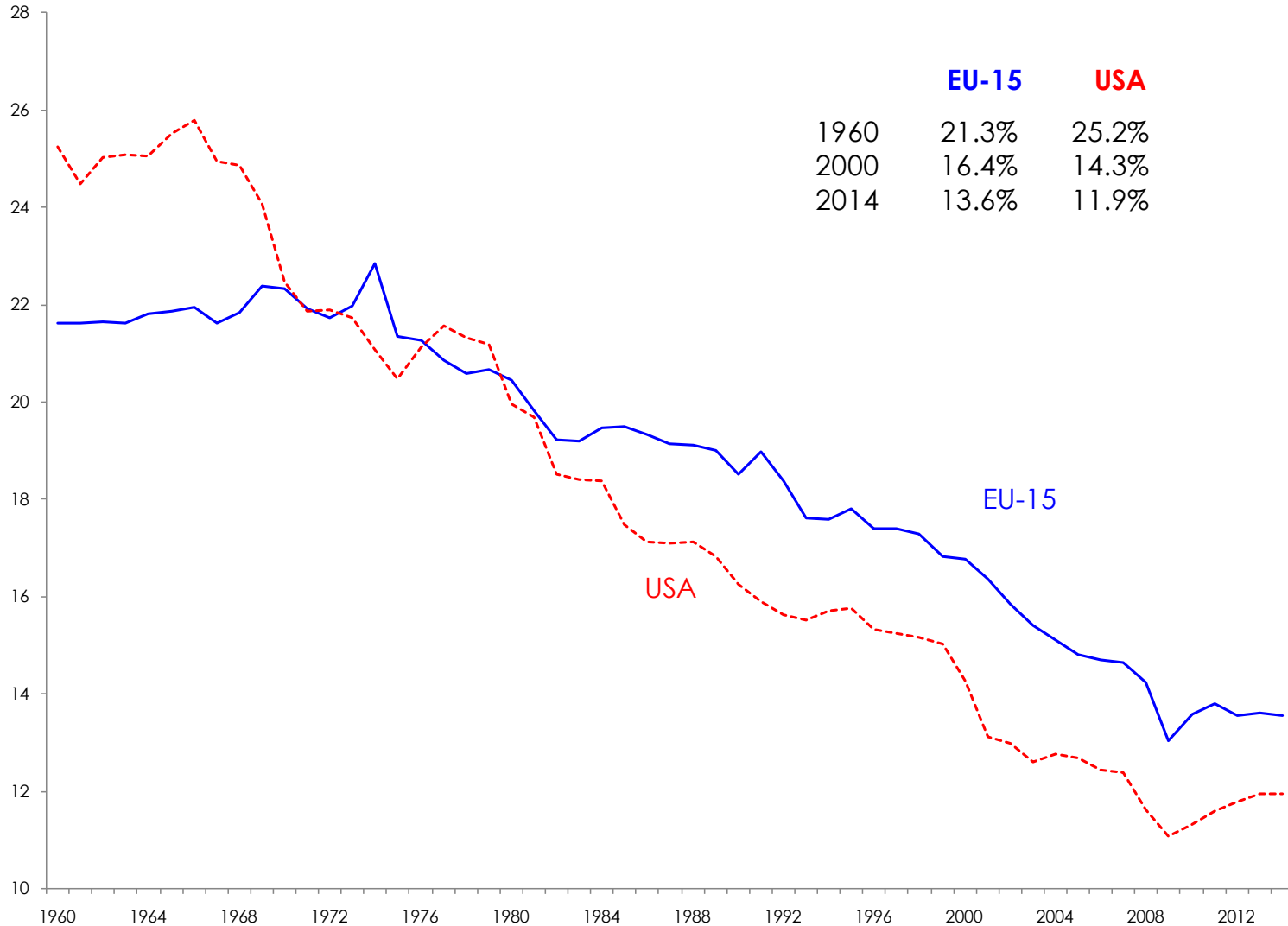
\*) GDP based on purchasing-power-parity (PPP), share of world total; IMF (<http://www.imf.org>).

Core Europe: Germany, France, Netherlands, Belgium, Austria, Finland.

EU plus neighbors: Albania, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia, Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey, Switzerland, Norway.

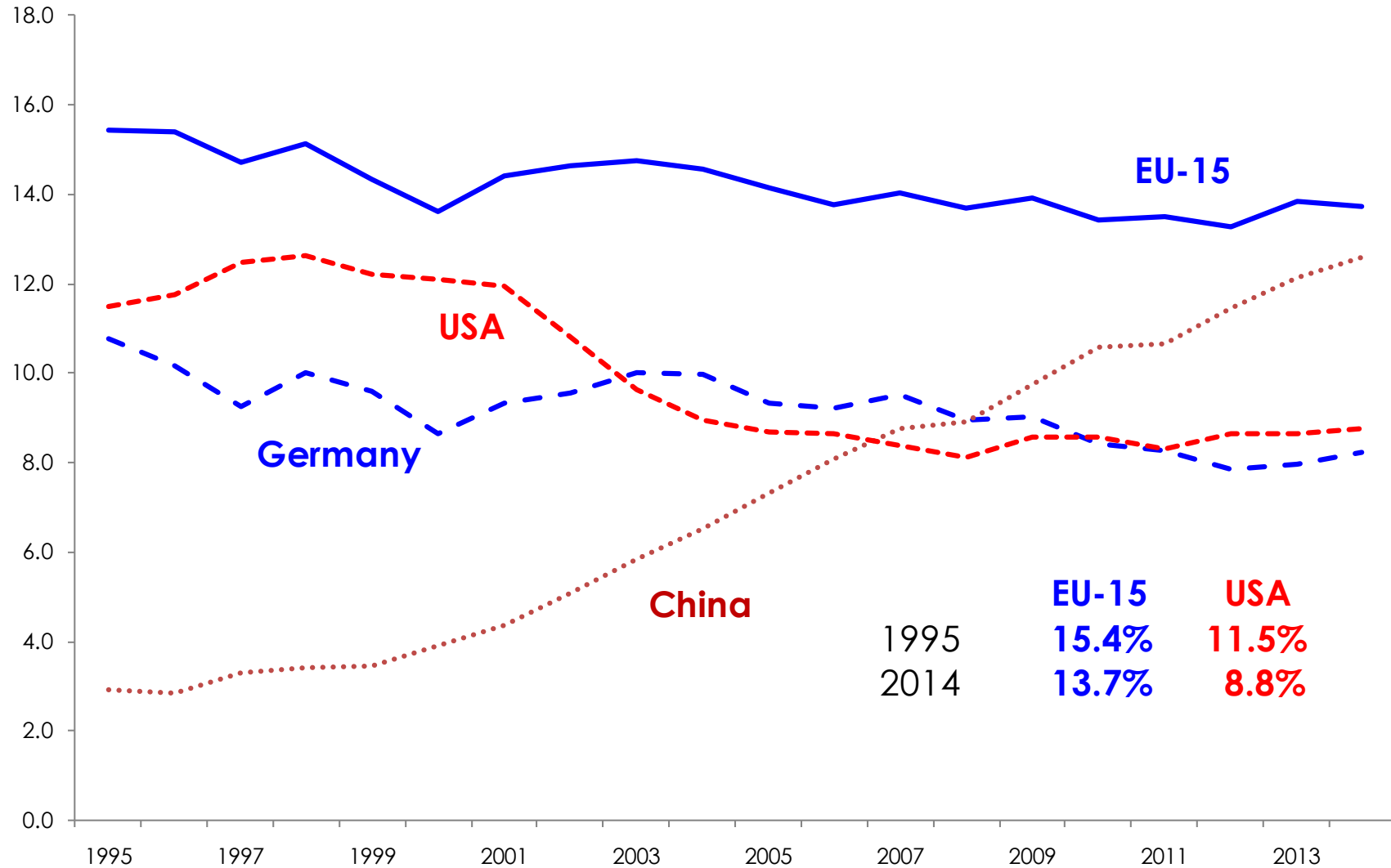
EU plus wider neighbors: Russia, Belarus, Israel, North Africa (Algeria, Egypt, Libya, Morocco, Sudan, Tunisia).

# The share of manufacturing in GDP: larger in Europe than in US (at current prices)



# Europe: Rather stable world market shares

Share of exports (in % of world exports)



	2010	2050	2010/2050
	Share in GDP in % <sup>1)</sup>		% p.a.
<b>Euro area</b>	<b>17.9</b>	<b>8.7</b>	<b>1.5</b>
<b>EU-27</b>	<b>24.2</b>	<b>12.4</b>	<b>1.7</b>
<b>EU plus wider neighbours</b> <sup>2)</sup>	<b>30.0</b>	<b>28.0</b>	<b>2.5</b>
<b>France</b>	<b>3.5</b>	<b>1.9</b>	<b>1.8</b>
<b>Germany</b>	<b>4.8</b>	<b>1.8</b>	<b>0.9</b>
<b>Austria</b>	<b>0.5</b>	<b>0.3</b>	<b>1.6</b>
<b>USA</b>	<b>22.8</b>	<b>13.3</b>	<b>2.0</b>
<b>China</b>	<b>15.9</b>	<b>23.9</b>	<b>4.5</b>
<b>India</b>	<b>6.3</b>	<b>15.6</b>	<b>5.8</b>

1) OECD members.

2) Albania, Bosnia/Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia; Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey; Switzerland, Norway.

S: OECD Economic Outlook No 93 - June 2013 - Long-term baseline projections.



# Current problems can be turned into part of the solution

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- Refugee crisis opens potential for **new dynamics**
  - Argument of ageing and decreasing labor supply is trash
  - Need for common European solutions became evident
- Brexit danger leads to rethinking which issues are regulated
- **Hidden assets of Europe**
  - EU not based on low, stagnant wages and dirty energy
  - Higher importance of energy efficiency, renewables
  - Work life cycle, lower working hours, more leisure
  - Incomes of “low 90%” are rising

⇒ **EU outperforming the US (© Wharton 2015)?**

- **Danger of disintegration (failed “Euro”)**
  - Political polarization within Europe and some members
  - Political instability in neighborhood, return to cold war
- **Muddling through with alternating crises and green spots**
- **Reaping the chances**
  - Decarbonization
  - Lower income spread
  - Experience of heterogeneity
  - Learning from each other and best practice

⇒ **Which scenario is most probable?**

**20%: Danger of disintegration (failed “Euro”)**

- Political polarization within Europe and some members
- Political instability in neighborhood, return to cold war \*

**30%: Muddling through with alternating crises and green spots\***

**50%: Reaping the chances**

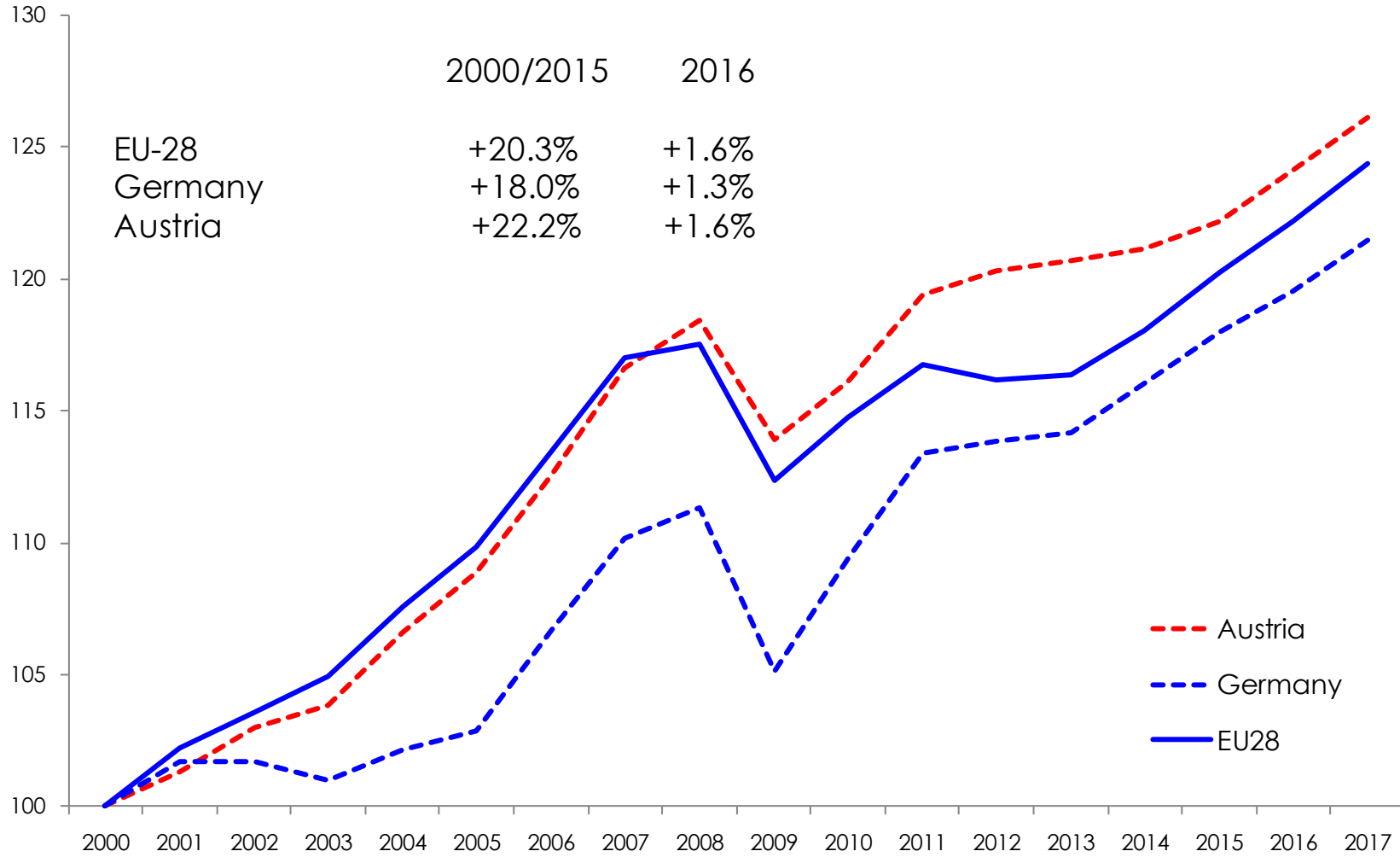
- Decarbonization
- Lower income spread
- Experience of heterogeneity
- Learning from each other and best practice

**⇒ The 21<sup>st</sup> century can still become Europe’s century.**

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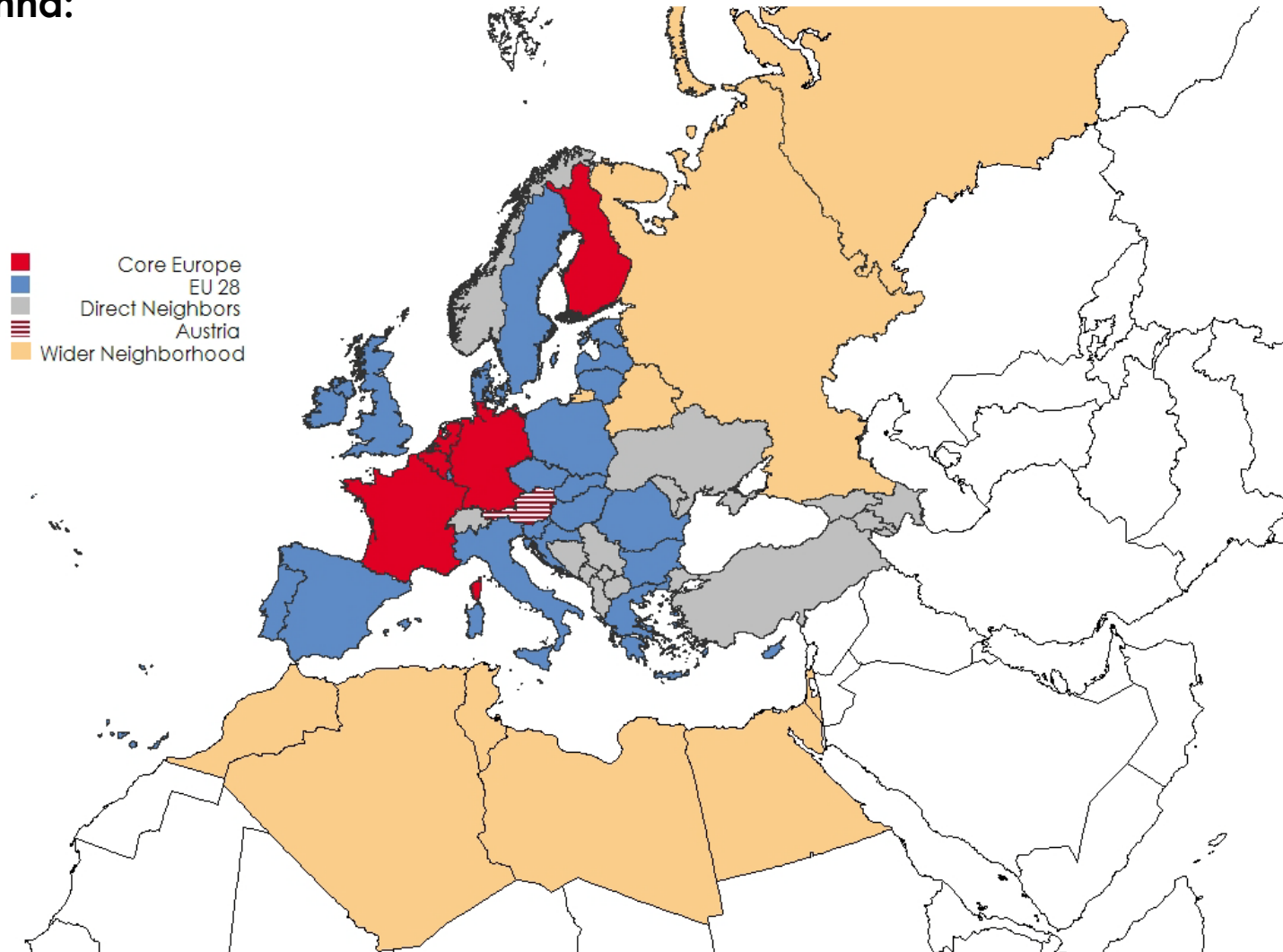
- Wealthy, diversified, large external surplus (3 bn € vs. US)
  - High performance (growth bonus 2000/12), low volatility,
    - Large manufacturing, tourism, high road: 4<sup>th</sup> in R&D
  - 4<sup>th</sup> in per capita GDP, 20% above EU, higher than D, F, UK
  - Low unemployment, income spread, stabilizing institutions
  - Top position in environmental technology, renewables
- ⇒ Risks, but even more chances from neighborhood
- ⇒ CEE, Black Sea, Middle East, North Africa.



# Equal distance to fast growing neighbors and Western Europe

Distance from Vienna:

- Lisbon 2,900 km
- Tripoli 2,400 km
- Ankara 2,100 km
- Kiev 1,300 km



## ■ Challenges

- Pressure from emerging countries
- Deepening specialization, **frontier strategy needed**

## ■ Hangover/low growth 2013-15

- Loss of **market shares** after 12 years of higher growth
- **Crises** in “new neighbor countries”: Ukraine, Russia, N-Africa
- Neglected **low third** and migrants in **education**
- **Leniency** in frontier strategy due to budget consolidation
- Too much money spent for **past priorities** rel. to the future.



- Ageing society leads to labor shortage; **definitely wrong**
- **Inflexibility** of labor, burden by social standards
- High **exposure** of banks, risky **geographical** position
- Public **sector risks** (see maturity, interest, structure of finance)

## **Chances dominate (if some homework is done)**

- Vivid neighborhood (incl. CEE), plus diversification (China, US)
- Fiscal and financial reforms progress, education deficits addressed
- Adequate “model” for more inclusive and decarbonized future

⇒ **Austria grows faster than Germany and EU since 2000**

⇒ **It will match probable top W-Europe in the next decade.**

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- No: continuation of political **inertia** and **pessimism**
- No: sorry, we have **low growth** and a lost decade
- No: sorry, we have **rising emissions** and **higher poverty**

### Strategy has to turn problems into growth dynamos

- **Decarbonisation**, empowering the **low third** (unskilled)
- Investing and stabilizing **neighborhood**
- Refugees end labor **shortage** and inflexibilities
- Brexit threat lead to reconsider **overregulation**

⇒ **EU has the potential for the best model of the 21<sup>st</sup> century**

⇒ **Less income divergences, plurality, lead in sustainability.**

# Austria will overcome hangover and - to some extent - lead to new strategy

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- High-road strategy, dynamic, open
  - Manufacturing base, high R&D, surplus, diversification
  - Threat of low growth due to ageing no longer founded
  - Investing into vivid neighborhood
  - Dynamics by low income spread and decarbonisation
- ⇒ Chances from neighborhood outweigh risks
- ⇒ Given - homework is done and - strategy is implemented.

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# WIFO ■ Austria's "ability to deliver goals"

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Beyond GDP goals	Rank Austria	Strength	Lead country
Income pillar	2	Household income	Luxembourg
Social pillar	4	Youth unemployment	Netherlands
Ecological pillar	7	Share of renewables	Italy
<b>Overall wellbeing</b>	<b>2</b>	<b>Income</b>	<b>Sweden</b>

Karl Aiginger: A New Strategy for Europe, Vienna-Brussels, 2016 (<http://Synthesis-Summary.foreurope.eu>).

	2000/2015	2000/2020	2010/2015	2015/2020
<b>Germany</b>	1.1	1.2	1.6	1.4
<b>France</b>	1.1	1.2	0.8	1.7
<b>Core Europe<sup>1)</sup></b>	<b>1.1</b>	<b>1.2</b>	<b>1.1</b>	<b>1.5</b>
<b>Euro area</b>	1.0	1.2	0.6	1.6
<b>EU28</b>	1.4	1.5	1.0	1.9
<b>EU plus direct neighbours<sup>2)</sup></b>	1.6	1.7	1.2	2.1
<b>EU plus wider neighbours<sup>3)</sup></b>	<b>1.9</b>	<b>1.9</b>	<b>1.2</b>	<b>2.0</b>
<b>EU-CEE<sup>4)</sup></b>	3.2	3.2	2.3	3.1
<b>North Africa<sup>5)</sup></b>	4.1	4.3	3.1	4.6
<b>USA</b>	1.8	2.0	2.1	2.5
<b>China</b>	9.6	8.7	7.8	6.2

<sup>1)</sup> Germany, France, Netherlands, Belgium, Austria, Finland.

<sup>2)</sup> Albania, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia, Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey, Switzerland, Norway.

<sup>3)</sup> Russia, Belarus, Israel, North Africa<sup>5)</sup>.

<sup>4)</sup> Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.

<sup>5)</sup> Algeria, Egypt, Libya, Morocco, Sudan, Tunisia.

# WIFO ■ It has to be a high-road strategy

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- **Productivity** more important than costs
  - **Competitive advantage:**
    - Quality, sophisticated products, technology
  - **Growth drivers:**
    - Innovation, education, universities
  - **Ambitions/Institutions:**
    - Social empowerment, ecological excellence, trust
  - **Objectives: Three strategic goals**
- ⇒ **Europe has to go for a high-road strategy.**



# WIFO ■ It has to be a two-stage strategy

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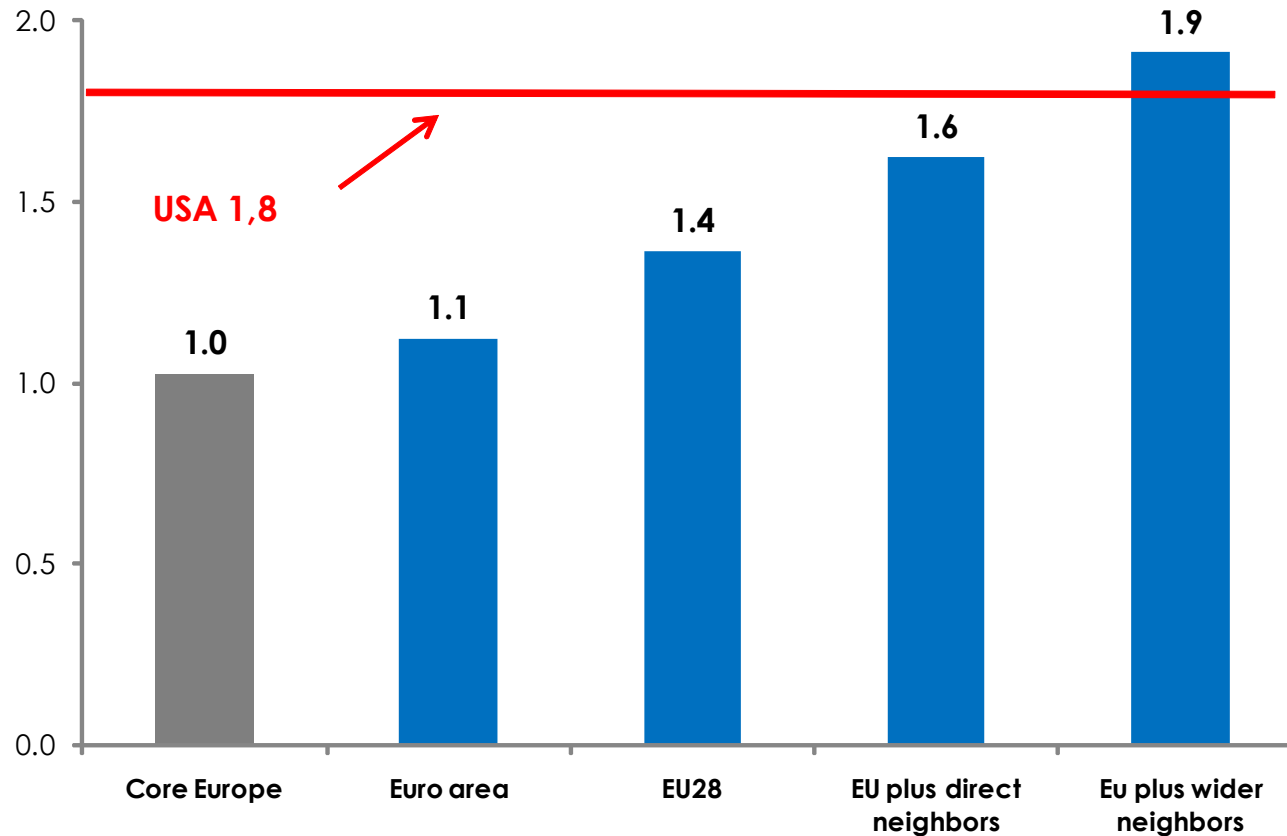
- In the very long run (rich countries) will have lower growth
    - Supported by decreasing marginal utility of income
    - Increasing non material values with rising income
    - Burn outs are neither warranted nor necessary
  - But over the **next 10 years** we have to have decent growth
    - For returning to full employment, paying back public debt
    - Favouring redistribution
    - Jobs for migrants and refugees
    - Driven by investment in decarbonisation and social innovations
- ⇒ **Tripling GDP up to 2100 (1.5% p.a.) neither feasible nor warranted.**

# Even the first stage cannot be **business as usual** but **investment in change**

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- New **infrastructure** much less dependent on fossils
  - **Social** innovations prepare for second stage
  - Changing institutions, **behaviour**, awareness
  - Redefine competitiveness towards **beyond-GDP** goals
  - Reduce dominance of GDP, address **goals directly**
  - Start **double decoupling** (emission **and** labour)
  - Support industry moving towards **4.0** (lower material/ energy)
- ⇒ **Energy Roadmap 2050**
- ⇒ **Zero Net Emission Goal (OECD, COP 21 Paris 2015).**

# Low growth in core Europe: vivid neighborhood (2000-2015)



\*) Gross domestic product based on purchasing-power-parity (PPP), share of world total.

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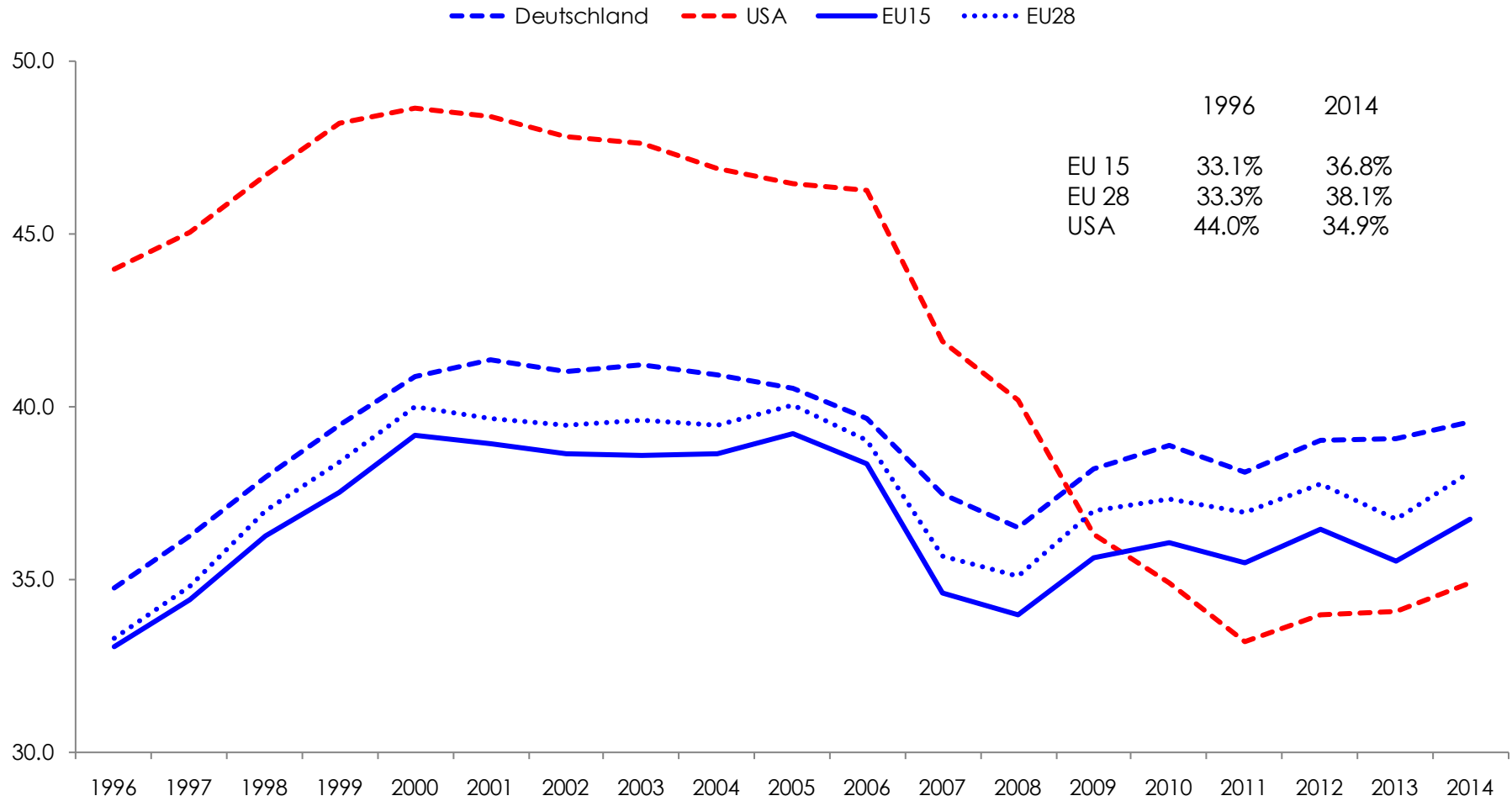
EU plus wider neighbours: Russia, Belarus, Israel, North Africa (Algeria, Egypt, Libya, Morocco, Sudan, Tunisia).

Source: World Economic Outlook, October 2015, International Monetary Fund. <http://www.imf.org>

- 
- **Core Europe:** Germany, France, Netherlands, Belgium, Austria, Finland.
  - **Direct neighbors:** Albania, Bosnia and Herzegovina, Kosovo, Croatia, Macedonia, Montenegro, Serbia, Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Turkey, Switzerland, Norway.
  - **Wider neighbors:** Russia, Belarus, Israel, North Africa.

Source: *World Economic Outlook, October 2015, International Monetary Fund.* <http://www.imf.org>

# Equalizing US position in technology driven industries in exports



- **EU: 'not in a good state': economically, public opinion**
  - **Pessimism will phase out if there is a forward-looking strategy**
    - dynamics, employment, lead in decarbonisation
  - **Europe will become a success model again**
    - investment into change
    - exchange with neighbours (Fulbright, ERP)
- ⇒ **Europe will become the best model for dynamic high-income regions.**

- **Pressure from catching up economies**
- **Dependent on external demand as small country**
- **Upgrading skills of lower third neglected**
  - **Integrating migrants (2<sup>nd</sup> gen) into school and training**
  - **Needed: Adapting vocational training**
  - **Frontier strategy for universities and innovation**
- **Deepening specialization and smart diversification**
- **Loss of market shares by political instability and investment trough**
- **Mobilizing structures and redirecting public sector.**

- **Public debt is medium, private debt is low**
- **Financial risks low (interest, maturity, structure, rating)**
- **Structural deficits are decreasing, Heta risk exists but "priced in"**
- **Share of public sector large, inefficiencies abundant**
- **Public sector pays for pensions for those not needing support**
- **Governance reforms could reveal big chances**
  - **For cutting expenditures, taxes**
  - **Boosting investment in skill**
  - **Innovation, ecology**
- **Labor highly taxed; energy, tobacco, alcohol, transport not.**



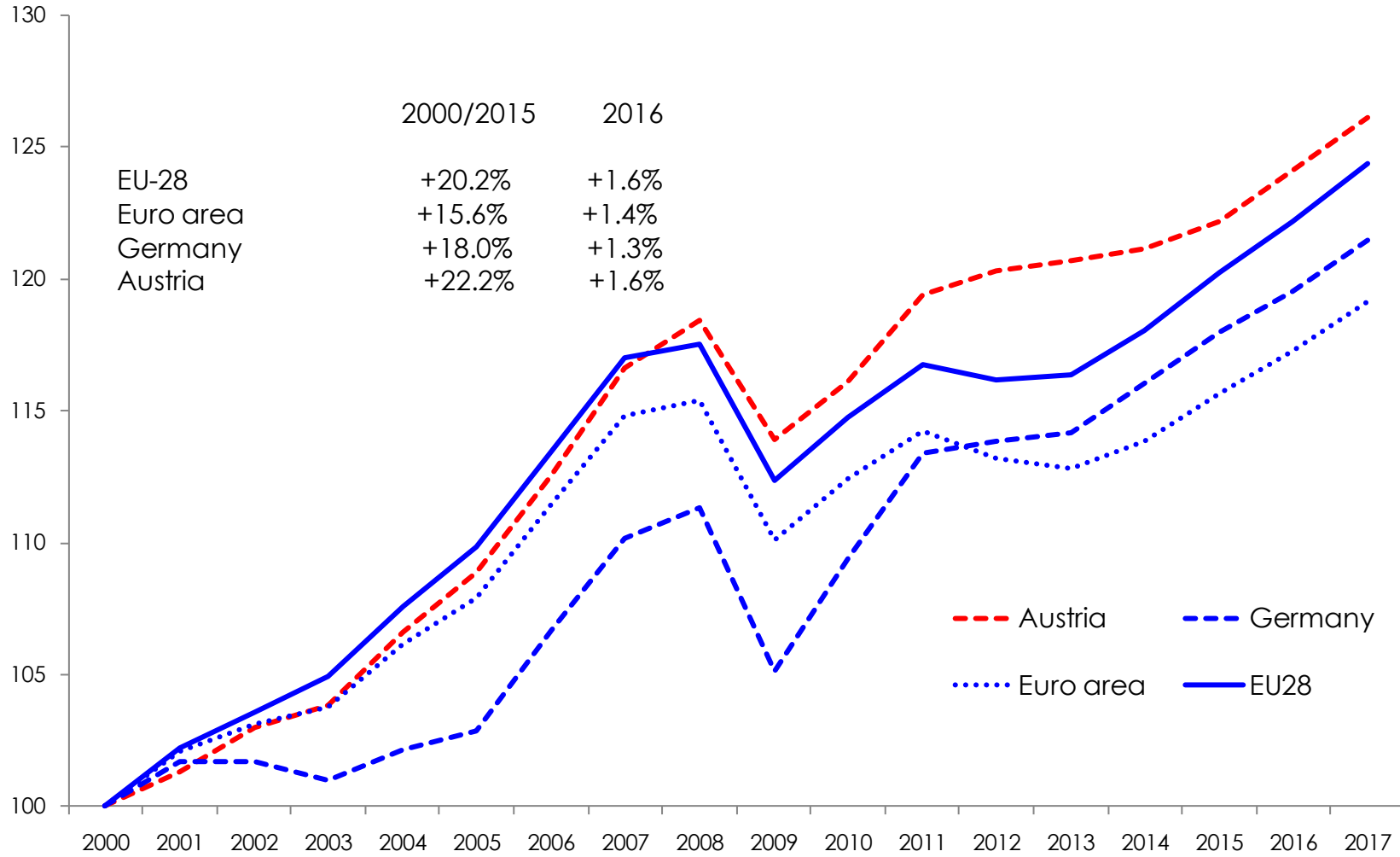
- Exposure to Central, Eastern and SE-Economies (CESEE)
- 60% (gross) and 40% (net) of GDP, but rather diversified
- Restructuring has taken place, Banking supervision
- Restructuring and resolution Act 2015
- Strong institutions, sometimes reluctant to change
- ⇒ Pro-European opinions dominate, critical to EU governance
- ⇒ Refugee crisis favors right wing tendencies incl. admiration for authority.

- **Potential: rising population & vivid neighborhood**
- **Successful diversification (China, US)**
- **External surplus, low private debt, public deficits declining**
- **Need for continuous reforms & technological excellence is on rise**
- **In Austria critical about public sector and institutions (bureaucracy) in all rating reports strong institutional effectiveness!!!**

- Frontier or backlash **innovation system**
- **Upgrading skills** or polarization
- **Political integration** vs. extreme parties
- Deploring the past or **investing in future**
- Low trend in labor productivity, **higher in resources**
- Inside orientation (fences) or **enjoying diversity, heterogeneity.**

- 
- **Lower growth based on ageing/ declining work force**
    - Is now definitely wrong; increasing supply up to 2030
    - And even later if migration trends continue
  - **Headline fiscal deficit declines (disguised by HETA resolution)**
  - **Recovering CEE, peace in neighborhood vs. refugees**
  - **Persistent large current account surplus**
    - Positive net investment position
  - **Great challenges Austria, larger chances.**

# Austria's growth since 2000 – higher than in Germany



# WIFO ■ Europe: A new strategy is needed

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- Based on strengths and preferences
  - “Europe is not in a good state”, economically, public opinion
  - Pessimism and ad hoc solutions are overcome by a new strategy
    - Dynamics, employment, lead in decarbonization
  - Problems can be turned into solutions
    - Refugees and labor shortage and inflexibility
    - Increase awareness of common solution needed
  - Brexit referendum helps to rethink what has to be regulated
- ⇒ Europe has the potential for best model for rich regions
- ⇒ Less income divergence, plurality, lead in sustainability.