A Growth Programme for Europe

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- Adopting the Fiscal Pact in its current form would require the simultaneous implementation of austerity policies in the countries of the Eurozone. The Pact is conceived in terms of neoliberal structural reforms and is aimed at unleashing the forces of growth. In fact, the crisis is intensifying markedly in a number of EU countries in the form of a downward spiral. A rethink is therefore urgently needed. Europe needs a growth policy with an investment programme.

- In order to arrest the downward spiral the size of the investment programme must emulate the successful Marshall Plan after the Second World War at 0.5 per cent of EU GDP (and around 2.5 per cent over a period of several years). A fast acting programme that can be put into place is based on amounts of the EU budget that have not yet been spent and will not have been spent by 2013, as well as reallocation of funds from the European structural funds. These resources should be disbursed as loans or subsidies. Furthermore, an equity capital injection would enable the European Investment Bank to lend significantly more.

- The Emergency Programme up to the end of 2013 should be supplemented by an investment programme oriented towards sustainability and innovation from 2014 to 2020. Priority in this should be given to economic projects such as energy efficiency, expansion of broadband cables and access to financial resources for small and medium-sized enterprises.

- A clear orientation towards profitability, stronger involvement of repayable financial products and stepping back from oversizing would avoid the mistakes of previous EU (budget) activities and increase the programme's positive multiplier effects.

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1. Dimensions and Background of the Crisis

The crisis in the Eurozone caused by the financial sector is proving to be lengthy and tenacious. European GDP shrank in 2009 and even in 2012 the consensus forecast is further negative growth; for 2013 and 2014 growth of only around 1 per cent is expected.

An unemployment rate of 11 per cent is currently estimated for the Eurozone for 2012 and 2013, which means a jobless total of around 17.3 or 17.4 million. In the EU as a whole the figures are around 23.4 and 22.9 million unemployed, which corresponds to a rate of 9.8 and 9.6 per cent respectively. At the end of 2011 Greece and Spain had unemployment rates of over 20 per cent (and youth unemployment rates now over 50 per cent), while in Austria and the Netherlands the unemployment rate is below 5 per cent (all data from the European Commission Spring Forecast of 11 May 2012: 11.4). Investment in the Eurozone, according to Eurostat, had fallen by 1.4 per cent in the first quarter of 2012 in comparison to the previous year, and by 0.9 per cent in the EU overall.

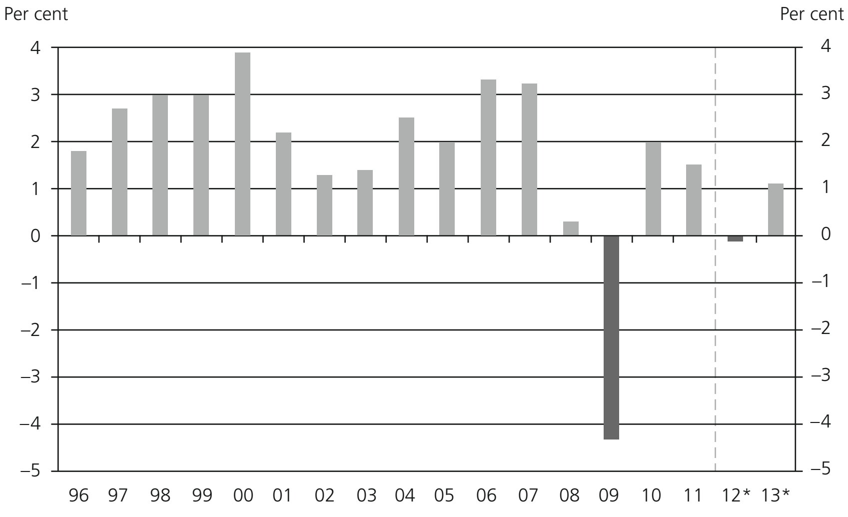
The crisis has gone on longer than originally expected. In particular, the short adaptation periods promised for individual states did not materialise. So-called structural reforms essentially based on cuts in state budgets, wage cuts, downward adjustment of social security benefits and making things easier for enterprises have not led to the expected upturn. In fact, the downturn is continuing longer than had been thought and indicators in some countries are pointing in the direction of downward spirals.

The example of Spain illustrates this development: in spring 2012 the rating agency Standard and Poors justified its downgrading of Spain's credit rating essentially in terms of its lack of growth prospects. On 8 June 2012 Spain's Central Bank estimated in its progress report that in 2012 the maximum state deficit agreed with the Troika cannot be achieved and that, as a result of the economic downturn, higher new borrowings than 5.3 per cent of GDP were likely.

The crisis symptoms that have appeared with increasing intensity since the investment bank Lehman Brothers went broke at the end of 2008 constitute the biggest global economic crisis since 1929. The trigger was a banking crisis which in turn had a number of causes. These include:

- The decoupling of the financial sector from the real economy and the dominance of financial capital over real capital. In 2007, the US financial sector's share of global added value was 40 per cent. The fiction of permanent

Figure 1: GDP growth in the EU, 1996–2013



Note: * Outlook.

Source: Griffith-Jones et al. 2012.

growth by means of capital gains allowed bubbles to form – especially in the United States and Spain – the bursting of which triggered huge devaluations and destabilised the banks.

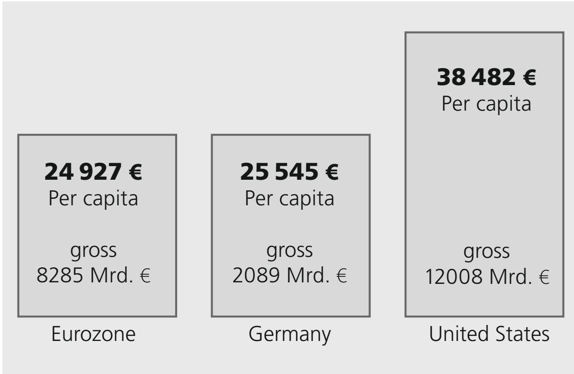
- The creation and sale of financial products favouring speculation and risky betting and speculative banking fuelled by the prospect of high yields, the outcome of which was often losses in the billions.

The US economist Nouriel Roubini spoke of a »monster bubble« as early as 2009 and predicted a systemic banking crisis (*Financial Times Deutschland,* 4 November 2009).

Many countries throughout the world reacted to these first symptoms of crisis by rescuing so-called »systemically important banks« and with large-scale economic stimulus programmes, »investing« trillions, often funded by loans. For Germany alone an indication of the direct costs of the crisis is the rise in public debt of around 470 billion euros. In the last year before the crisis struck net new borrowings were virtually nil, but in the meantime they have grown significantly, due to tax revenue loses as a result of the crisis, bailing out the banks, anti-crisis programmes and automatic stabilisers. All in all, public debt grew by 18 percentage points to 83.2 per cent.

The current sovereign debt crisis is therefore for the most part a consequence of the international financial crisis – even though there is no doubt that in particular countries excessive public debt had already been accumulated before the crisis or wage increases outstripped productivity growth or household debt had mushroomed. The current global debt crisis is of such dimensions that entire countries are threatened with insolvency if decisive measures are not taken. The debts of the United States, Japan and the EU total around 10 trillion euros.

Figure 2: Level of public debt, 2011



Source: Der Spiegel 21, 21.5.2012: 69.

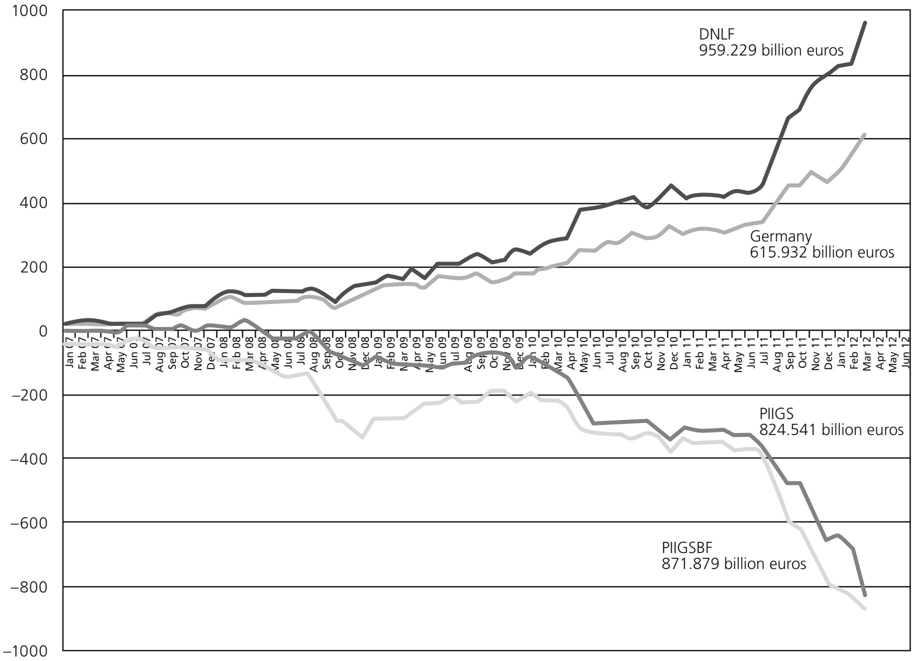
Recently, attention has focused on Greece and Spain. As a result of the high cost of borrowing – with interest rates considerably above growth rates – they are falling ever deeper into debt, their viability is severely compromised and at least over the long term (perhaps even in the short term) they may be unable to refinance or service existing loans.

The considerable current account differences within the Euro Area are undoubtedly a further cause of the crisis. Widely divergent unit wage costs and persistently high current account surpluses run by a number of countries, such as Germany, while other countries run considerable current account deficits have generated a multitude of problems within the framework of a common currency. A split is developing in Europe between economically strong and weak regions (countries), with the weaker parts experiencing significant difficulties generating growth and increasing exports. The state's ability to alleviate social problems is hampered and at some point may be exhausted.

Measures are needed to overcome divergent productivity. This is in the long-term interest of all countries: serious economic difficulties in one region of Europe are currently having massive repercussions on others, including Germany. Germany thus has a close interest in overcoming the crisis. The Federation of German Industry (BDI), in this connection, points out that 70 per cent of Germany's exports are to the rest of Europe, over 60 per cent in the EU and over 40 per cent in the Eurozone (BDI 2011b: 1).

The extent to which the economies of EU member states are drifting apart – even if only with regard to their

Figure 3: Target-2 balances in Europe (up to March 2012, billion euros)



Notes: The figure shows the Target 2 balances of the so-called »DNLF« central banks (Germany, Netherlands, Luxembourg, Finland), Germany, the PIIGS (Portugal, Ireland, Italy, Greece and Spain) and the PIIGSBF (PIIGS including Belgium and France) from January 2007 to March 2012.

Source: http://www.querschuesse.de/target2-salden/ (accessed on 24 May 2012).

need for central bank money – is illustrated by Target 2 flows. Target 2 is a clearing system for the transfer of money between the banks participating in the system. The balances of the participating commercial banks as well as central banks that are not part of the Euro Area must show a positive balance or be balanced at close of business each day. The balances of issuing banks in the Euro Area, on the other hand – the so-called Target 2 balances – can be negative or positive. Up to 2007, accounts were usually balanced. In the meantime, strongly positive and strongly negative positions have built up that indicate an extremely high injectiion of liquidity by the central bank (negative balance) or a very low injection (positive balance). The central bank's exposure is not owing to its provision of liquidity, however, but to the value of the securities that the banks deposit with the central bank for these provisions and, under normal conditions, overcollateralise.

2. Neoliberalism Led Us into the Crisis But Wont Lead Us Out of It Again

According to the core beliefs of the doctrine that has dominated economics in recent times a crisis of this magnitude should never have happened. Reality shows us otherwise, however: the crisis is here, it doesn't appear to be going anywhere and the austerity policy, which mainly comprises spending cuts, has rather exacerbated the situation than improved it. Neoliberalism offers no explanation of the crisis and no prospect of solving it. On the contrary: in particular the financial market liberalisation that can be traced back to this approach bears a considerable part of the blame for the generation and sheer magnitude of the crisis.

It is not surprising that economists who have criticised neoliberalism for decades have now redoubled their assault. They take issue with neoliberalism's responsibility for the policy of deregulation (see, for example, Stiglitz 2011), criticise the false assumptions and declare the bankruptcy of this approach. There is further condemnation of the neoliberal view of human beings as unfit for a society that aspires to fairness, justice based on individual performance and freedom (Misselwitz 2012).

What is surprising is that the profound shock experienced by neoliberalism has now been brought home even to the conservative propagandists of the freest and least regulated capitalism. Thus Klaus Schwab, organiser of the World Economic Forum in Davos, in January 2012 confronted the global economic elite with the assertion that »capitalism in its current form no longer fits the world« (FAZ.net, 28 January 2012). *Spiegel Online* (29 December 2011) by way of example commented on the volte-face of a prominent economist: »Thomas Straubhaar, formerly neoliberal professor at the University of Hamburg and head of the Hamburg Institute of International Economics rashly announced the imminent end of the financial crisis … His blatantly false prognosis and the erratic prophesies of many of his colleagues brought about a radical rethink on his part. ›We have to ditch the myth of the efficiency of financial markets‹, he now says.« Dennis Snower, President of the Kiel Institute for the World Economy, was cited in *Handelsblatt* (16 April 2012) as saying: »Our basic assumption that people always act egoistically and rationally is in fact false and does great damage to our field.«

Handelsblatt can be credited with succinctly clarifying the fundamental errors of neoliberal doctrine. The following five positions are particularly worth mentioning:

1. Gearing the economy to short-term profit maximisation (shareholder value) based on the belief that this benefits society as a whole; this goes hand in hand with the neglect of a long-term orientation and the obstruction of long-term financing.

In the last parliamentary term the European Commission under Barroso, together with Commissioner McCreevy of Ireland, wanted to effectively abolish long-term financing by permitting withdrawals from financing at short notice with no penalty. But what is presented as a customer-oriented measure would in fact mean that long-term financing would no longer be economically viable and thus exacerbate the volatility and vulnerability of the financial system.

2. Gearing economic modelling exclusively to *homo oeconomicus* when describing human behaviour as a whole. All too often, macroeconomic models based on this lead to false policy recommendations because they fail to understand social norms, group behaviour and political decision-making.

3. Gearing economic policy to rational expectations. The herd instinct – a key cause of financial bubbles – is thus eliminated by definition, asymmetrical information (and therefore the superior knowledge of many financial actors in relation to their customers) is neglected and Keynes's »money illusion« is viewed as in- or no longer operative.

4. Gearing financial market regulation to the assumption of efficient and deep financial markets. On this view, market prices are always correct and there is no distorted price and bubble formation (or only exceptionally) because all future information is discounted. However, in the past, financial, share, commodity and real estate markets have regularly led to over- and underpricing at variance with the state of the real economy.

The very strong alignment of interest rates on government bonds after the introduction of the Eurozone underestimated many risks over many years or expressed the expectation that there would be a full bailout in the event of difficulties. However, the fact that, when the first difficulties arose, the interest rate spread went to the other extreme of very high interest rate differentials cannot be explained by the assumption of a bailout.

5. Gearing central and issuing banks to consumer prices, largely leaving out of account credit volume and asset prices. This orientation relinquished preventive action before the crisis and thus drove its costs upwards, prolonging and deepening it more than necessary.

Joseph Stiglitz's critique of the standard macroeconomic model (Stiglitz 2011)

In his *Adam Smith Lecture* delivered in Glasgow in 2010 Joseph Stiglitz, Nobel prizewinner for economics, described the failure of the neoliberal model:

- it declared that crises such as the present one don't exist (because, for example, in this model unemployment is only a disruptive effect resulting from too high wages, not a permanent phenomenon given flexible labour markets and low wages);

- it neither depicted nor explained the misguided incentive structures of the financial sector, with its enormous bonuses (because according to it market discipline leads to efficient and stable incentive structures);

- it did not feature bubbles, nor was it able to understand them before they burst and assumed that it is more effective to react only once a crisis has set in than to prevent it;

- it did not point out that it can happen that the money supply and lending can diverge dramatically because in a crisis the credit supply collapses and cannot automatically be restored, even by additional money supply including quantitative easing;

- the fact that in its »microeconomic foundations« of the macroeconomy its model of the representative agent as homo oeconomicus was mistaken in so many respects;

- the fact that it understood fluctuations and thus crises solely as the effect of external shocks (thus as a result of external effects influencing the economy) and did not allow for the fact that crises can also be generated by the economy itself (endogenous), whether as a result of volatility or irrationality;

- the fact that it did not take into account multiplying effects (snowball effects) in the spread of the crisis because in practice it considered only the interest rate, but not the prices of goods (asset prices) which have much greater leverage and because it inferred from the global distribution of new financial products that there would be greater stability instead of recognising the new risk category of a simultaneous global crisis.

Stiglitz has formulated a number of new approaches beyond neoliberalism, starting from the basic idea that the globalised economy and, in particular, its financial sector is more vulnerable than had been thought, thus necessitating active government intervention:

- a better understanding of systemic risks and effective control of them;

- a massive increase in transparency since the shifting of financing from banks to anonymous markets raised intransparency and the risks that go hand in hand with that to a new level (information asymmetry);

- better monitoring and separate measures to expand the credit supply (conditional on a rapid solution for the bad debts on the balance sheets of banks, insurance companies and other financial institutions); and

- the inclusion of an active transformation policy for sustainable recovery whose aim is to stimulate private investment by means of well-designed public investment: »Public investments can even ›crowd in‹ private investments. In normal times, the effects of excessive austerity can be offset by loose monetary policy, but that is not so today, when interest rates are zero. Welldesigned expenditure programs can even lower the long-run debt« (Stiglitz 2011: 8ff).

There is no getting away from the realisation that (i) simultaneous austerity policies in a big region such as Europe by no means automatically lead to growth, but rather trigger a downward spiral, (ii) a state that is not afraid to regulate and has greater influence over the economy is needed as *one* agent of an anti-crisis policy and (iii) sustainable growth can be achieved not by the financial sector but best of all by the real economy.

Adequate state revenues are as much part of this as combining activities to initiate sustainable growth. This growth must be aimed at strengthening the real economy and for individual countries reinforcing competitiveness, because »in the first instance the Euro crisis is a balance of payments crisis and thus a crisis of competitiveness on the part of the member states« (Priewe 2012).

3. The German Government's Crisis Policy Has So Far Lacked a Convincing Strategy

Germany and the German political system have been slow to react to the crisis. As the crisis mounted over the course of a year up to the insolvency of Lehman Brothers in September 2008 – sub-prime portfolios were already getting into increasing difficulties from summer 2007 – in Germany the talk was only of isolated cases. The systematic importance of the crisis and the broad threat of the financial sector were scarcely recognised. Vital windows of opportunity to prepare a response to the crisis were either thrown away or not used decisively enough. As usual, an early response is better and cheaper.

In the last quarter of 2008 the Grand Coalition in Germany realised that it faced a systemic problem. The government reacted with its first packages of measures for the banking sector and to protect savers. However, it took a relatively long time before they realised that specific anti-crisis measures were needed. Even after it had become evident that this was a deep crisis likely to go on for several years the CDU/CSU/FDP government that came to power in 2009 failed to develop a comprehensive strategy. The government seemed to believe implicitly in the viability of the Maastricht system which had conceived of a currency union almost as a kind of autopilot without the need for continuous steering and control. The boundaries supposedly laid down by the Constitutional Court and the expected mood of the voters certainly contributed to the fact that Germany avoided a deeper commitment to a proactive European response to the crisis. What remained was the implementation of an austerity policy which served only to exacerbate the crisis in countries which already found themselves in difficulties. The German government's policy seemed to lack direction and to be driven by rapidly changing events. Acute risks of state insolvencies and the break-up of the Eurozone led to the conception of rescue packages which gave rise to a series of real and potential payment obligations for Germany which are to be regarded as different classes of burden imposed by the financial crisis and its consequences:

Class 1 (government debt): existing government debt increased by 470 billion euros.

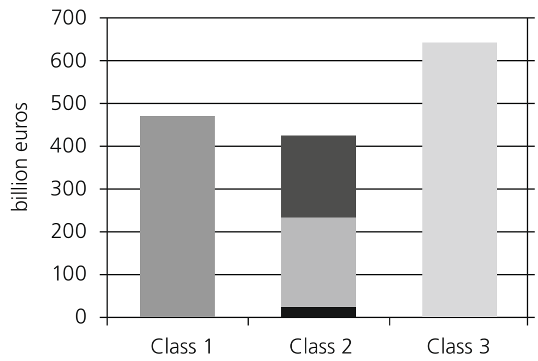
Class 2a: (loans and guarantees): loans and guarantees to other European countries total 400 billion euros. This includes aid to Greece (which at first was given as a direct loan from states, including around 24 billion euros from Germany) and Germany's maximum liability in the *European Financial Stability Facility* (EFSF) and the permanent stability fund the *European Stability Mechanism* (ESM). In contrast to the dramatically higher government debt this involves loans or guarantees aimed at bringing it about that as large a proportion as possible does not enter into effect or is repaid. These funds are at risk from a payment default by a state. Looking back, such loans were always predominantly repaid in the event of a state bankruptcy, albeit after a considerable delay.

Class 2b (consolidated loans and guarantees): many people include here the participation of Germany or other European countries in the International Monetary Fund (IMF) and the corresponding portions of IMF components of the aid packages (for Germany, around 15 billion euros). Again, it applies here that in the past the IMF got back its loans from aid packages with a time lag. It appears even less plausible to »consolidate« the portions of the *European Financial Stabilisation Mechanism* (EFSM) in the aid programmes since the EFSM is financed from the EU budget.

Class 3a (central bank payment balances): finally, some include here the so-called target balances of central banks between one another in the European payment system, which according to *Handelsblatt* (5 June 2012) has risen to 644 billion euros for the Bundesbank: this does not include assistance loans or transfers but liquidity originated by the central bank which is distributed unequally among the Eurozone countries. The rather speculative idea is that the security provided with the central bank is not sufficient for the liquidity obtained if a country declares itself unable to pay and exits the EU and thus the Eurozone. Since the national central banks of the relevant countries both now and in the future have assets in euros, however, here too the vast bulk of servicing – sometimes with time delays – will be done vis-à-vis the European Central Bank (ECB).

Class 3b (consolidated central bank activities): if, in addition, consolidated portions of central bank balance sheet totals are sometimes mentioned alongside government bonds purchased outside the usual ECB mechanisms (for Germany, 57 billion euros) there is an evident desire to produce big numbers. Such a risk would only occur for Germany, however, if the ECB became insolvent. That is extremely unlikely because it receives security for making funds available and thus possesses considerable cover.

Figure 4: Effects of the financial crisis on Germany, by class and volume



Note: Consolidated items such as Germany's shares in IMF programmes are not depicted.

- Target Bundesbank to other Euro-states
- ESM
- EFSF
- Greece loans
- Increase in government debt

Germany's higher government debt due to the implosion of the financial system in 2008 and the guarantee obligations of the German state that have not yet materialised, as well as the imbalances in the central bank system that concern the Bundesbank must be treated separately. However, the obligations overall are high and will tend to get bigger, without any real strategy on the part of the German government to overcome the crisis being in evidence. Certainly, growth in the crisis countries is a key condition for ensuring long-term viability and ability to pay.

Germany has also made a number of gains from the Euro crisis, however. The worries of investors and, to a lesser extent, also speculation about a future without the euro and the strong gains in value that a »DM II« might enjoy have driven interest rates for German government debt to record lows at which investors in short-term bonds have to put up with zero interest. Even in the 10-year benchmark maturities interest payments below inflation are payable (by comparison, while before the crisis Germany paid approximately 4 per cent interest for this term, in 2012 values below 1.4 per cent have been attained). In purely arithmetical terms, in the long term 2.5 percentage point lower interest rates offer an annual saving potential of 50 billion euros on a government debt of around 2,000 billion euros. Naturally, this saving, given an average maturity of 6.4 years for government debt, only comes gradually; in any case, the interest payments on German government bonds on average have already fallen to 3.1 per cent (*FAZ* 29.05.2012). Overall, the low exchange rate of the euro, caused by the crisis in the Euro system, and the low interest rates of the ECB support exports, benefitting Germany enormously.

It is entirely legitimate to expect a country with a particularly strong economy and which has benefitted considerably from the existence of the Eurozone to make a particular contribution to resolving the crisis. It must not be forgotten, of course, that not so long ago Germany was talked of as »the sick man of Europe« and itself registered a debt level that breached the Maastricht criteria. Furthermore, the debt brake embedded in the German Constitution sets limits on further borrowing. To that extent, there are restrictions on Germany's ability to contribute financially and on its liability with regard to Europe.

4. A New Strategic Approach to Overcome the Crisis

Instead of dissolving Europe, terminating the European project and trying to return to the past it can only be in Germany's interest to seek »more Europe« and to reinforce competences at the European level. The BDI is in agreement: »No European country on its own – including Germany – has the potential to assert its influence on the global stage. The fortunes of the world economy will in future no longer be decided at a G8 or G20 level but at a G2 or G3 level. When reassessing what course it should follow, Europe must decide whether it is able and wants to become the third player in this partnership. German industry needs a strong Europe in a dynamic world economy. Politicians can achieve this goal via their policy-making powers. All they have to do is use it« (BDI 2011b: 7).

Reinforcing competences at the European level requires:

- on one hand, more democracy and thus more a »European method« via resolutions in the European Parliament and not at intergovernmental conferences;

- on the other hand, strengthening permanent capacities for intervention at the European level, particularly in the event of crisis, which requires the expansion of the EU budget. Switching to proper European revenues – making it clear to European citizens where their money goes – instead of transfers from national budgets seems to make sense.

We find ourselves in a dramatic crisis situation in which a simple »business as usual« approach has nothing to offer; there is no quasi-automatic solution to the crisis on the horizon. A new policy approach is indispensible, which:

- reduces the danger of repeats of the financial market crisis by means of extended regulations and implements structural changes in the financial system;

- implements structural reforms to modernise societies and enhance states' competitiveness (this includes, for example, improving tax raising, local government reform and making it easier to establish companies);

- maintains or increases states' scope of action through increased revenues;

- acknowledges the limits of state borrowing and at least prevents a further unfettered debt increase (this is not just a matter of austerity but also a lowering of the interest rate burden on crisis countries: »The most urgent challenge is the stabilisation of interest rates on government bonds at a level below the rate of economic growth« (Schulmeister 2011: 15));

- sends a strong and durable signal to the markets;

- avoids automated collective austerity whose simultaneous application will »lead the economy into a crisis lasting years« (Schulmeister 2012: 1), which is the danger of having a fiscal pact without a (equal) growth pact; and

- musters the resources needed for a massive high quality growth programme (New Deal or Green New Deal for Europe of the same magnitude as the Marshall Plan) and implements it (on the Green New Deal see Dullien et al. 2011: 188ff).

Real success can be achieved only if progress is made with stabilising the financial sector. Two elements play a key role in this: (i) the prompt separation of bad debts (in bad banks or deconsolidated environments), otherwise the financial system threatens to become dysfunctional with regard to new loans and (ii) a strong signal to the markets on the preservation of the Eurozone and the limiting of interest rates on government paper.

At this point we shall not look at the issues of financial market regulation. By and large, what is needed is to return to the fore the banks' role as service providers for the real economy. Among other things, the financial sector needs to be downsized and limits placed on its power, a European banking regulator (at least for the 25 biggest »systemically important« banks) and a European rating agency, the linking of aid payments and recapitalisation measures with the state taking over parts of companies (ranging from limited shares, as in the case of Commerzbank, to nationalisation, as in the case of HRE), the division of banks and the restriction of their lines of business (separation of commercial and investment banking), a ban on short selling and certain highly speculative financial products, as well as the limitation and control of high frequency trading.

What we can discuss briefly here is the importance of the role of strong countries within the framework of such a strategy. Emergency programmes and medium-term programmes in the countries directly affected by the crisis will be successful only if they, at the same time, kickstart meaningful developments in the EU countries with current account surpluses for the purpose of limiting or reducing them. If one looks at Germany it is obvious that investment activity is too low and that the country is consuming its capital stock (by a good 1 per cent a year), while compared to other countries the wage share is comparatively low.

The Eurostat analysis for 2010 reveals that households' investments are at a similar level in Germany as in the other Eurozone countries, namely 5.88 per cent of GDP in Germany (in comparison to 5.44 per cent). Government investment in Germany amounts to 1.64 per cent of GDP (2.53 per cent in the Eurozone), companies' investments 9.98 per cent in comparison to 10.83 per cent. Overall, investment in Germany is 1.3 per cent of GDP lower than the EU average. This investment gap is around 30 billion euros a year (Eurostat 2012).

The bulk of investment is in the private sector. However, the state has its own role to play: not only by investing itself, but also by creating the conditions for and promoting innovation, as well as supporting access to the appropriate financing instruments.

The main measures the state can take to increase the wage share are to create a general statutory minimum wage and to curb precarious employment (see Herr 2012: 4). The social partners have the wage agreements and, within the framework of collective bargaining, a series of regulatory options concerning agency work, as well as the hiring of apprentices. The wage agreements for 2012 are clearly going in the right direction. But although there appears to be a majority for a statutory minimum wage in the Bundestag, that is not the case in the government.

In what follows we shall present, first, steps to preserve states' viability in a difficult economic situation (with individual countries experiencing markedly different degrees of difficulty) by helping to curb interest payments (Section 5), measures to improve the revenue situation (Section 6), the concept of a growth strategy (Section 7) and action principles for an investment programme (Section 8).

5. A Debt Repayment Fund to Limit the Interest Rate Burden

Germany's Council of Economic Experts presented a working paper in January 2012 in which the danger was pointed out, should the crisis continue, that countries could lose the ability »to refinance outstanding loans on the international financial markets […] A liquidity crisis could thus develop into a solvency crisis.« Unless decisive steps are taken to stem the interest burden for many countries there is a risk that the crisis will intensify, as a consequence of which the following may occur:

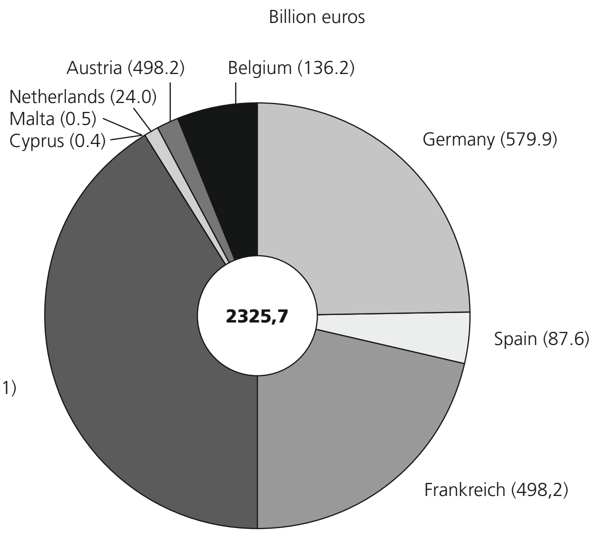
»(a) the ECB, in response to renewed financing bottlenecks of much greater magnitude than previously would have to purchase government bonds;

(b) the euro countries would have to agree almost overnight to unlimited Community financing through Eurobonds;

(c) the Monetary Union would break up uncontrollably« (German Council of Economic Experts 2012: 2)

In autumn 2011 the German Council of Economic Experts developed a proposal for a debt repayment fund as an alternative to any kind of surrender of limited liability on the part of Germany, on one hand, and the disintegration of Europe, on the other hand. This redemption fund comes into play in the event of public debt rising above 60 per cent and transfers them to a redemption fund with regard to which primarily the relevant state bears the burden of repayment, but to which a joint and several guarantee supervenes which comes into play in case of late payment or default.

Figure 5: Debt redemption fund in the Euro Area, 20111



Note: Public debts that exceed the debt rate of 60 per cent. Greece, Ireland and Portugal are not included because they are in adjustment programmes.

If all states participate this fund would contain a good 2,300 billion euros, which would have to be repaid 25 years after a phase in of up to five years. Since the fund will be able to obtain better refinancing conditions in the market than most states, the latter will be able to obtain some relief when repaying their public debt. For example, in the case of Italy it would have to pay 3 per cent rather than 6 per cent for its debts. Interest rates for public debt below 60 per cent would also diminish, according to the logic underpinning the fund, since the capital markets know that, for example, Italy can no longer issue government bonds higher than 60 per cent of GDP in order to benefit from the debt redemption fund. If one assumes, in simple terms, that 4 per cent interest would be paid on these particular bonds – in other words, the easing would be »only« 2 per cent – the notional easing for Italy would be 3 percentage points of GDP in the case of which the primary budget surplus would have to be lower in order to achieve long-term debt relief for the country.

The concept of eurobonds for public debt follows the mirror image of this. These bonds support, with Community liability, the issue of public debt up to 60 per cent (blue bonds); beyond that the relevant state issues red bonds for which it is exclusively liable (Delpla/von Weizsäcker 2010). There is a strong economic incentive to issue state debt above 60 per cent as little as possible since the additional interest rate for these red bonds will be great. However, it will be greater than for the unprotected part in the other concept of the redemption fund, as it covers the range beyond 60 per cent. In the case of Italy with a total public debt of 120 per cent of GDP higher interest of 1 percentage point for the red bond component – thus in the example 5 per cent instead of 4 per cent – requires an additional primary surplus of 0.6 per cent of GDP per year (in a »steady state«). With a Eurozone GDP of around 9,400 billion euros in 2011 the upper limit of the eurobond could be set at around 5,600 billion euros, in other words, 2.4 times as large as with the redemption fund.

Both variants would undoubtedly be a strong and robust signal to the markets. By comparison, it is clear that the redemption fund:

- is characterised by a smaller and better defined volume (which was always an important criterion in the relevant negotiations of Germany's Constitutional Court);
- has a greater effect on interest rates for the non-covered portion; and
- establishes a more transparent control regime even for the non-covered portion.

Overall, the redemption fund appears to be the more likely looking model.

It was already mentioned that the terms of issue for Germany are »unnaturally good« at present and involve a considerable amount of »anxiety«. If measures such as the debt redemption fund help to calm the markets – which is the intention – the refinancing costs for Germany will increase, according to the calculations of the German Council of Economic Experts, to 2.5 to 3.0 per cent (German Council of Economic Experts 2012: 6). Before the crisis they stood at around 4 per cent for 10-year government bonds. Furthermore, if Germany participates, the share of German public debt above 60 per cent – about 589 billion euros – would have to be serviced under the terms of the redemption fund, in other words, at around 3 per cent. Germany's notional refinancing advantage in relation to the pre-crisis situation would fall from 2.5 to – if the worst comes to the worst – 1 per cent. Thus Germany's maximum refinancing advantage would fall from 50 billion euros a year to 20 billion euros if the entire public debt is issued (in the case of short maturities a better refinancing advantage would result at present) and through the continuous revolving of existing debt affects interest rates everywhere. Politically, this is an investment in the long-term calming of the financial markets and the future of Europe.

6. Increasing State Revenues with a Financial Transaction Tax and Putting an End to Tax Evasion

For the purpose of combating the debt crisis and for financing growth programmes without new borrowing it makes sense to significantly raise state revenues, with the largest portion going to debt repayment. Besides forcing the better-off individuals to contribute more to financing the society and community (with the help of instruments such as a wealth tax applicable throughout Europe and a top tax rate of around 50 per cent) two avenues look particularly promising: (i) the introduction of a financial transaction tax and (ii) effective action against tax evasion and avoidance, together with the integration of the black economy in the legal economy.

By introducing this tax the European Commission expects to obtain revenues of around 57 billion euros a year. In national terms, additional revenues for Germany of 10 billion euros a year would mean that paying off public debt, which in the financial crisis has risen by 470 billion euros, would take 50 years – not including interest! This is therefore a fairly modest contribution to be imposed

Eurobonds – Same Name, Different Nature

1. Delors Bonds

Then president of the European Commission Jacques Delors wanted the EU budget to be able to borrow in order to realise major EU infrastructural projects. This remains prohibited, however, the main exception being made for the EFSM within the framework of combating the financial crisis, enabling it – subject to a cap – to help support countries outside the Eurozone. As the crisis dragged on and deepened the EU summit permitted intervention for the sake of Greece. The proposal from new French President Hollande revives the proposal concerning earmarked financing of European infrastructure projects.

2. Blue Bonds

The best known variant of the Eurobond was proposed by the Bruegel think tank in Brussels. This would involve Community borrowing at the European level quite similar to joint borrowing by the federal government and the states in Germany. Such a mechanism makes it easier for the states to achieve their expenditure cutting targets. They are much less dependent on financial market fluctuations (not to mention speculation). Community borrowing would be coupled with adherence to milestones as regards national consolidation programmes and to that extent prolonged or halted at regular intervals. It would be limited to 60 per cent of GDP (in 2011 this amounted to a good 5,600 billion euros in the Eurozone as upper limit, if the 60 per cent indebtedness is exploited to the full by all countries and also issued as Eurobonds). The 60 per cent upper limit was chosen because it is the accepted upper limit of state borrowing according to the Maastricht Treaty, while according to the Euro-Plus package and other recent agreements such as the fiscal pact it represents the target for austerity measures in the relevant countries. Any borrowing beyond that would be on the relevant countries' own responsibility and thus be subject to higher interest obligations (red bonds).

3. Project Bonds

Project bonds have nothing to do with public debt; the term is therefore unfortunate. Germany's scepticism towards the proposal can partly be traced back to the fact that it is often misunderstood as public debt. The risk buffers furnished by the EU budget – up to 5 billion euros a year – for project financing by the European Investment Bank are limited in volume, however. Such projects are supposed to be realised within the framework of the existing budget and to avoid any burdening of future budgets.

4. Redemption Fund

At the end of 2011 the German Council of Economic Experts proposed a debt repayment fund for Europe. It is structured inversely to the blue bonds and gathers together all public debt in the relevant countries above the 60 per cent of GDP limit. At the end of 2011 that amounted to around 2,300 billion euros. The idea is that the participants in the fund have joint liability. If Germany participates the Council of Economic Experts estimates interest rates of between 2.5 and 3.0 per cent which the fund would have to raise for this kind of 10-year Eurobond.

5. EIB

The EIB, the EU's development bank which has similar tasks to Germany's Kreditanstalt für Wiederaufbau (now KfW Bankengruppe), is owned by the 27 member states (not the European Commission). It is financed, besides its paid-in capital, entirely through capital market issues and enjoys a AAA rating. This good rating is based, first, on ownership, second, on the orientation of project financing towards profitability and third, on its good asset book with very few defaults. In recent years bonds have been issued in the amount of 60 to 80 billion euros a year.

on the financial sector to compensate for the damage it has caused.

The financial transaction tax has three functions:

- registration of transactions should take place via the stock market, making the large number of inadequately recorded and unnetted over-the-counter (OTC) trades more transparent and easier to control in a crisis;

- control of certain products without an underlying transaction, such as derivatives or of unexecuted positions in high frequency trading;

- generation of revenue for the state (in case of an introduction below the level of the EU27, first of all for national budgets).

Part of the revenues from the financial transaction tax should be used to cover debts at the national level, another part at the European level to boost intervention capacities and a third (smaller) part for growth initiatives.

In currently dominant European policy not only is structural policy with structural adjustment measures overweighted (which means that support for growth and investment is lacking), but astonishingly the sole emphasis is on labour flexibilisation and scaling down the social fund. Structural policy must attend more closely to the following areas:

- reduction and prevention of tax evasion and avoidance;

- improvement of tax collection at existing tax levels;

- the reduction and prevention of illegal employment and integration in the legal economy;

- implementation of internal prices in international companies that reflect value added; and

- detection and prosecution of money laundering.

The additional state revenues that could be obtained by consistently combating tax evasion and avoidance are difficult to quantify. It has been claimed that it will take ten years to clear the debts of European states, but only with really effective measures. Even if that is too optimistic the head of the Greek tax investigation office estimated at the beginning of June (*tagesschau.de* of 8.6.2012) that Greece loses between 12 and 15 per cent of GDP through tax evasion, around 40 to 45 billion euros.

With regard to the shadow economy relatively reliable information exists for individual countries. In the past, however, little specific action was taken to reduce it significantly. Current data for Germany identify 13.5 per cent of GDP as non-registered – and not taxed – production; in individual sectors this is up to 38 per cent of actual output. For Austria and Switzerland the figures are 7.9 per cent and 7.6 per cent, respectively, the best in Europe (Schneider 2012). Since the European overall average stands at 19.2 per cent and thus is much higher than in five other highly developed OECD states (Australia, Canada, Japan, New Zealand and the United States), at 9.2 per cent, the potential for improvements is considerable. Should it prove possible to redirect 2 per cent of GDP from the shadow economy to the real economy, that alone would be worth over 250 billion euros. Should it prove possible to close the gap with the other OECD countries the figure is 1,250 billion euros a year. Assuming a tax ratio of 20 per cent we can estimate that states would receive additional revenues of 250 billion euros a year.

7. Different Strands of an Investment Programme for Growth and Employment

It will not be possible to lead the Eurozone or the EU out of the crisis without sustainable growth because »consolidation succeeds – almost always – through growth« (Priewe 2012). Thus budget cuts and restructuring alone are not enough.

7.1. Objective, Approach and Dimensions

What is needed is an additional growth-promoting investment strategy that:

- also shows immediate effects;

- focuses on economic viable projects (entirely or in large part refinanced by themselves in the future and do not give rise to future burdens in their respective countries);

- in particular helps competitive small and medium-sized enterprises (SMEs) to grow;

- also creates jobs through start-up companies; and

- is carefully targeted and thus uses resources efficiently.

In the current situation whatever is economic viable and geared towards sustainable growth is a step in the right direction. The orientation towards economic viability in general and economic viable projects in particular is important and something new. It is particularly important to avoid creating burdens for the future. EU projects are often not designed in such a way, as we know from oversized sewage treatment plants in eastern Germany and the excessive number of excessively large industrial parks throughout Germany. Also roads which are used by too few cars and which, contrary to the successful example of the Golden Gate Bridge – financed within the framework of the New Deal in the United States – do not generate sufficient revenues to finance themselves, as far as possible, give rise to burdens for the future.

Also necessary are mandatorily binding targets and financial and technical provisions which make it possible to meet targets, as well as bringing them under democratic control. A worthwhile initiative must be determined to succeed and for that reason in particular must be feasible, of sufficient size and not subject to overoptimistic expectations. After all, this is a time of crisis.

The historical experience of the Marshall Plan after the Second World War can give some indication of the magnitude of the undertaking. The Plan for Europe for its part comprised 13 to 14 billion US dollars. That was a good 0.5 per cent of (European) GDP which was injected into the economy each year over a longer period (around five years) with additional investment resources, amounting overall to about 2.5 per cent of GDP.

There is every reason to believe that new, more stable growth can come only from the real sector, not the financial sector and this means that the real sector should receive a higher proportion of value added.

The real economy is conceived broadly in this connection. The growth possibilities of the industrial economy – with the industrial core, but also with a rising proportion of production-related and logistical services – should be boosted and expanded. These services can be integrated in manufacturing companies or can be separate. In particular, complex and specialised services will in future increasingly be provided and sold in conjunction with goods. Industrial services understood in this way will therefore in future, in parallel with industry and the industrial economy, be a key driver of economic growth (Eickelpasch 2012: 52).

7.2. Using the EU Budget

The EU budget makes up around 1 per cent of EU GDP. In order to give impetus to reliable growth all important positions of the EU budget must be addressed, not only a few small special budgets. As far as magnitude is concerned, from 2014 to 2020 the European Commission plans to spend a total of 1,000 billion euros, 39 per cent on agriculture, 38 per cent on the structural funds, 9 per cent on employment and social security and 8 per cent on research and innovation.

To give an impetus for growth lasting several years the 55 per cent – totalling 550 billion euros – envisaged for structural funds, employment and innovation are accessible. Hitherto Germany has preferred to trim by 10 per cent – 100 billion euros or around 16 billion euros per year – the structural fund resources that are available for intervention for the peripheral countries, thereby forgoing in particular the growth-promoting effects. Instead, there must be reallocation within the budget in favour of boosting growth and innovation.

As things stand at the moment the structural funds make available to countries with regional development problems between 2 and 3 per cent of the GDP of the relevant region. The outflow of funds has been very sluggish in the financing period since 2007 and during the crisis it has generally been slower than planned. A quarter of structural fund resources were still not allocated at the end of 2011, in other words, were not assigned to a project. With regard to the allocated funds some of the projects were implemented more slowly or not at all. Thus in 2012 and 2013 – and with redemption by 2015 – there will be a considerable remainder. Within the framework

Figure 6: Structure of the EU Budget (European Commission proposal for 2014–2020)

<table>
<tr><th colspan="3">Structure of the EU budget</th></tr>
<tr><td rowspan="2">Structural funds 376 billion €</td><td colspan="2">Other 34 billion €</td></tr>
<tr><td>Administration
63 billion €</td><td>Research Innovation
80 billion €</td></tr>
<tr><td rowspan="2">Agriculture 387 billion €</td><td colspan="2">Employment
Social security
88 billion €</td></tr>
<tr><td colspan="2">Foreign policy 70 billion €</td></tr>
</table>

Figure based on *Handelsblatt,* 26.4.2012

of the emergency programme it is now a question of redesignating resources that are not flowing. Furthermore, some room to manoeuvre should be obtained by resizing oversized projects.

More flexibility is needed here from both European and national administrations.

The aim is to systematically reallocate resources into cost-effective projects organised in accordance with the principle of »first-come first-served« that meet their targets:

- energy efficiency;
- boosting competitive and successful export companies;
- prefinancing of SMEs with orders in their order books yet whose access to credit is unsatisfactory;
- setting up companies by the unemployed;
- financing of innovation in companies and start-ups; as well as
- financing of infrastructure for a more efficient and more sustainable economy.

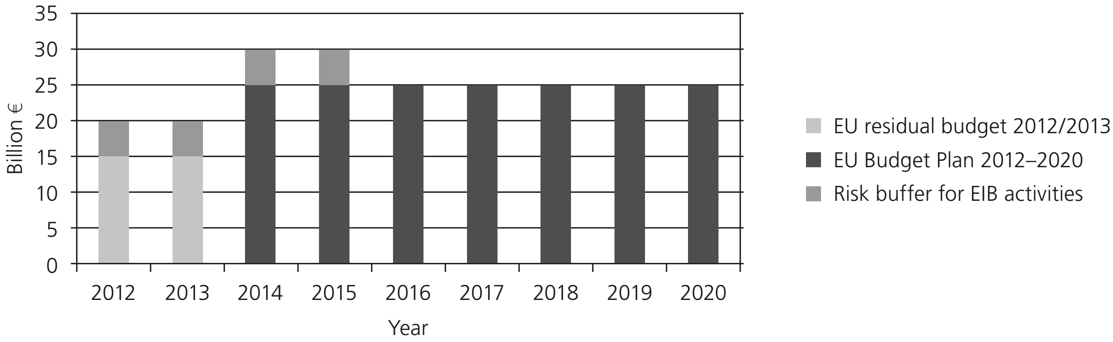
The pattern of increases should be that at least 0.5 per cent of GDP is made additionally available and combined with technical assistance for proper resource flows. That ranges from the preparation of application dossiers through support for tender procedures to help with project management during implementation.

It is important that such an emergency programme is responsive to long-term needs and targets. This is because it saves investment in the future and avoids even higher investment (or repair costs) in contrast to not investing. In connection with the discussion of a »Green New Deal« it is emphasised that promoting innovation and developing infrastructure are particularly important (Dullien et al. 2011: 190). The emergency programme sketched here and the medium-term growth programme up to 2020 can be designed with regard to such aims.

With an effort, around 20 billion euros a year can be raised from the EU budget (up to the end of 2013) for such a growth initiative within the framework of an emergency programme by means of redesignation and reprogramming. The volume must be increased for the financial perspective from 2014 to 2020 first to around 30 billion euros a year and from 2016 stabilised at 25 billion euros in order to make a credible success of the long-term restructuring of economies such as Italy, Portugal or Spain. If one takes the special case of Greece it becomes immediately obvious that a very long-term social restructuring process is involved.

Even the maximum value of 30 billion euros comes in at only 0.25 per cent of average EU GDP. Bringing a larger portion of such an emergency measure to bear than this medium value will certainly be possible in countries with support programmes, whereas in countries that can manage more easily from their own resources the portion will be less. However, investments in the stronger countries also have positive effects for growth in Europe as a whole. Thus a corridor or bandwidth of 0.5 per cent of

Figure 7: Additional investment from the EU budget



GDP in the case of maximum deployment and 0.125 per cent in the case of minimum deployment suggests itself.

This level of investment must therefore be supplemented from other sources and its multiplier effect leveraged as much as possible. But that will not be possible without the EU budget.

7.3. Utilising Leverage Effects and Deploying Project Bonds

Utilising leverage effects with regard to the EU budget is, by and large, the simplest and most promising way of harnessing the European Investment Bank (EIB) effectively. Part of the EU budget is fully used as a risk buffer. Thus EIB loans for projects are less risky and financial viability can be established, also at higher volume or lower interest rates. The planned leverage effect in the case of the most mature product (innovation) was planned with fivefold leverage: 1 billion euros from the EU budget as risk buffer makes it possible to lend 5 billion euros in risky areas. In fact, sixfold leverage was observed, which exceeded expectations. Since the defaults were much lower than in the case of a cautious risk analysis the 1 billion has not been used, but for the most part returned to the EU budget. Revolving deployment would be even better.

Empirical experiences are already available in this area. There are successful examples in the financing of innovation (RSSF) and in regional financing (JESSICA, JEREMIE). The Greek SME initiative that has just been signed also belongs here. The planned EU project bonds, which do not involve EU debt but expand EIB activities, are similar.

In the case of major projects, based on the concept of project bonds, it could work as follows: private capital invested in insurance companies and pension funds could be mobilised for these projects through the involvement of the EIB and the lower risk for the investor that goes with it. Before the financial crisis this was absorbed through the so-called monoline insurance companies (such as AIG) with whose help the whole project was shifted to a AAA rating. Such insurance is no longer available in the wake of the financial crisis.

Project bonds would be more modest. The private investor brings 25 per cent in own capital. The EIB finances the next 25 per cent as a mezzanine tranche (subordinated loan). The aim is that the remaining 50 per cent (priority loan) have a BBB+ or A- rating and thus are financially viable for the funds and insurance companies. In the case of this mezzanine tranche the European Commission would in turn relieve the EIB of half the risk via the risk buffer, which is liable for the first losses incurred. The EIB would remain involved in the financing throughout the course of the project and thus also represent an additional quality element for insurers and pension funds.

Since the financing of the EIB thus harbours less risk for itself than if it did it from its own resources the procedure also functions in the case of existing capital resources. Internally the EIB, in contrast to project and special financing undertaken by itself, can do four times the volume of low-risk business if it obtains this buffer. On the political side, the price that must be paid for the risk buffer is that the EIB expands its financing for a growth programme of the kind described here, in other words, increases its annual financing from 50 to 60 billion euros.

Figure 8: Additional investments from EIB loans based on the risk buffer from the EU budget

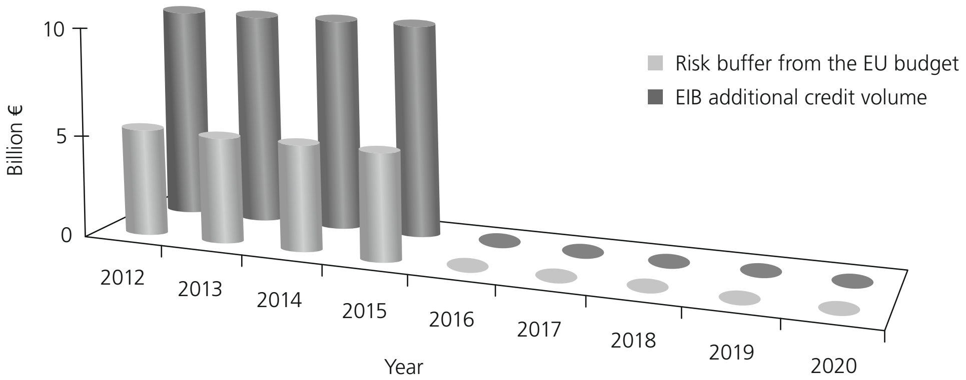
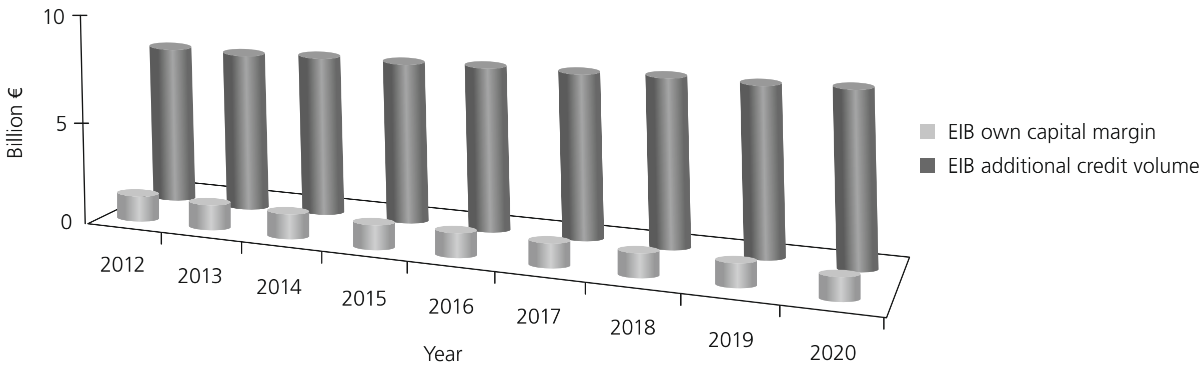


Figure 9: Additional EIB lending on the basis of a selective equity injection



If the aim is to achieve a financing volume of 160 billion euros over four years, that corresponds to additional EIB financing of 10 billion euros per year. For four years 20 billion euros are needed from the EU budget for the risk buffer for the EIB 40 billion euros (25 per cent of 160 billion).

These 5 billion euros a year for 2012 up to 2016 are drawn from budget resources and presented in what follows with regard to the additional EIB volumes with a multiplier.

7.4. Boosting the Equity Capital of the European Investment Bank

The EIB will not be able to play a more active role within the framework of large-scale growth programme without the injection of fresh money – and that will not be possible for all EU states.

Why is that so? In the past, equity capital increases came from accumulated gains and the EU countries added 20 times as much in guarantees on top of that. Of the EIB's 232.4 billion euros in subscribed capital, therefore, only 11.6 billion are paid in. The EIB has operated successfully in every year of the crisis and was able to increase its annual earnings from around 1.4 to 2.3 billion euros last year, so that it increased its ability to bear financial risks.

Nevertheless, the rating agencies no longer accept such a concept for future capital increase, which is also due to the development of supervisory regulations put in place in response to the crisis. When ratios are introduced which are, quite properly, independent of the leverage effect and also of underestimated risks in risky financial models (leverage ratios) the rating agencies also apply them to the EIB (and no doubt at some point to KfW). In plain terms that means that they look more at the injected capital and no longer trust that if necessary the member states will in fact make available the guaranteed sums. As a result of sensible anti-crisis measures the EIB's volume of credits in relation to actually paid-in capital and capital accumulated from profits has increased more than ninefold and the rating agencies demand that it return to eight. Since in the case of an equity contribution on the old pattern »only« the guarantee sum is increased nothing changes in this leverage ratio. Furthermore, even the provision of guarantees for many EU member states would be critical.

An increase in share capital in order to increase investment capacity is also possible only if Germany, along with likeminded countries, injects money. In order to avoid overspill effects and to bring it about in a controllable way that EIB investments are actually increased a selective earmarked equity injection makes sense which does not increase the agreed equity capital but raises the paid-in portion. If Germany injects a further 5 per cent for earmarked equity capital with a separate reporting requirement that would involve around 1.9 billion euros from the Federal budget. Payment can be spread over several years. Future revenues from the transaction tax can be used for this purpose. What is important in that case, however, is that it is not necessary to change the guarantee framework 20-fold but it can be reduced by the volume amount. Assuming that there are sufficient willing countries, so that 10 billion euros are accumulated, the participation of the big countries is required, including Italy and Spain, which is certainly optimistic.

Even with a leverage ratio of »only« 8, however, the leverage value is good – and thus better than with the EU budget, at between 4 and 6. The financing is concentrated on economic projects, as is usually the case with the EIB. Such tied capital could be dedicated particularly to industrial policy objectives, from innovation financing through SME support to economic beacon projects, such as the cable connection of the best solar sites in Europe in Crete to the mainland, which is definitely viable, but no investors can be found.

It would seem to make sense to emphasise the selectivity and earmarking that characterises increasing EIB's equity capital. Thus after 12 years repayment is due by means of special dividend payments (special dividends). The EIB can and must prove on the basis of earmarking that it is really using and allocating additional volumes with this capital, in other words, not just concealing cuts in other places. There are certainly EIB shareholders that would like the EIB to engage in fewer activities and do not consider it to be an active promoter of growth.

For the rating agencies a tied equity capital increase would constitute positive proof that the shareholders are standing by the EIB and developing it further, which should significantly simplify the debate on the AAA evaluation and its jeopardisation without improving the leverage ratio.

7.5. Total Volume of an EU and EIB Investment Programme

Two additional effects can be achieved with the EIB. The first follows from a selective tied equity capital injection of 10 billion euros from those member states that are ready to provide it. That enables additional EIB loans of 10 billion euros a year up to 2020. The second follows from a deployment of EU budget resources for a risk buffer for financing infrastructure projects (project bonds), as well as companies' innovation projects. With 5 billion euros a year from the EU budget 10 billion euros in EIB loans can be initiated, assuming a four-year initiative.

We thus end up with (accumulated):

- 15 billion in budget activities in 2012 and 2013 (balances, rapidly redesignated and not repaid to the net contributor), as well as 20 billion euros in EIB loan activities (10 billion backed by the budget, 10 by the equity capital increase), making 35 billion euros per year;

- hopefully budget activities worth 25 billion euros in 2014 and 2015 and again an annual 20 billion in EIB loans (again 10 billion backed by the EU budget and 10 billion by the selective equity capital injection), making a total of 45 billion euros per year;

- from 2016 to 2020 it remains at 25 billion euros in budget activities, as well as 10 billion annually in EIB loans, making 35 billion euros a year.

It would appear to be important for the political discussion to launch a reliable investment programme of this magnitude in order to set in motion a credible sustainable growth impulse that will really move Europe forward.

To refer to the Marshall Plan once again, the present plan is designed for a longer time period than its predecessor since the construction of productive economic structures requires time, although the size of the stimulus is around the same, at around 2.5 per cent.

8. Doing Things Better: Operational Principles of an Investment Programme

8.1. Changing the EU's Cofinancing Obligation

In the crisis, the European Commission – with the assent of the German government – has progressively reduced countries' cofinancing obligation. In the case of Greece it has fallen to practically zero. But that is the wrong approach. Obligatory cofinancing was introduced to give member states incentives to plan projects responsibly, based on their own stake in the budget. With cofinancing of 5 per cent or less that is no longer the case, however. Not a single oversized project has been resized. Thus no prestige project has been converted into an economic one. Another approach would therefore make more sense: the cofinancing obligation will be dropped if revolving loans are promoted. First, de facto cofinancing is achieved by means of repayment because the subsidy value is rather 50 per cent than 100 per cent. Second, relending by the member state will lead to a long-term strengthening of investment and innovation capacity and this relending is a further major cofinancing effect that even surpasses the relevant obligations.

8.2. Giving Preference to Revolving Funds

In the past EU support was largely conceived as a grant system. Although revolving funds have been permitted for around 10 years – like some other financial instruments – they are relatively little used. The introduction of loan instruments in revolving funds for the largest possible proportion of the abovementioned growth and investment programmes, besides solving the cofinancing problem, enables the following positive effects:

- the modulation and adjustment of subsidy intensities for those projects that need only minor (or more minor) support impulses;
- an increase in allocation efficiency;
- stabilisation of investment resources even after repayment or after a future phasing out of structural funds in regions that manage to achieve growth.

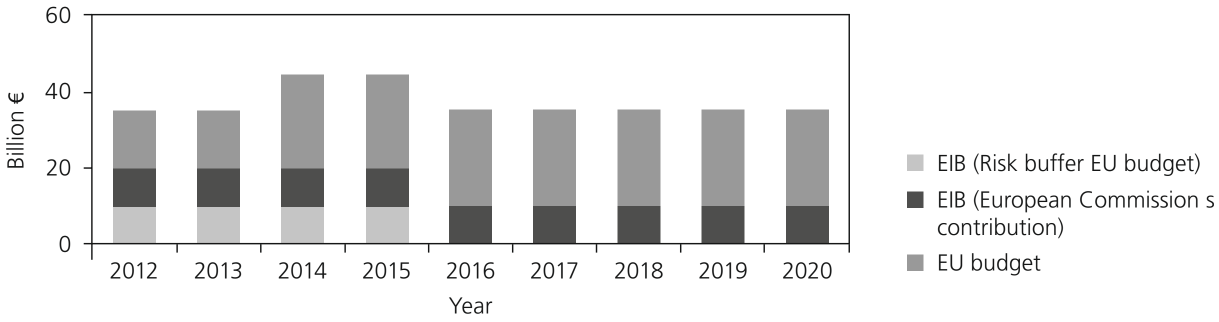
8.3. Responding to the Needs of SMEs

SMEs employ the lion's share of workers. A growth and investment programme should therefore include a substantial component for supporting SMEs. The key aims in this respect are:

- supporting well-performing SMEs without access to the financial market to prefinance existing orders through the financing of working capital;
- helping to increase the productivity of SMEs which have their head office in crisis countries and are able to export in order to strengthen and expand competitive operational structures;
- facilitating business start-ups in particular as spin-offs from universities and other educational institutions;
- facilitating SME growth in their regions by rapidly implementing European programmes that create decentralised regional order structures, such as energy efficiency measures in existing buildings.

In the case of SMEs it is particularly clear that structural reforms and investment promotion can usefully interlock. Administrative modernisation and streamlining help to promote company start-ups; SMEs are able to invest significantly less without legal security and swift resolution of legal issues in the judicial system; a transparent tax system is crucial for success in order, on one hand, to limit administrative costs in the case of tax payments, but on the other hand to ensure revenues for the state, which are sorely needed in the crisis countries.

Figure 10: Total volume of an EU and EIB investment programme (subsidies and loans)



8.4. Long-term Financing for Long-term Investments

In a number of countries only relatively short-term credit periods are available in the domestic currency. If companies or enterpreneurs then resort to euros or Swiss franks they run a currency risk which in crises has proved difficult or even uncontrollable, as developments in Hungary have shown in the past few years.

The redesignation of structural funds and other EU programmes as financial instruments (financial engineering) should thus improve conditions for investment in durable goods. A manifest market failure can thus be avoided at least partly and reliability significantly improved for private investors. In this way it should be possible to stimulate more private investment.

8.5. Ensuring There Is No Future Burden on State Budgets

Future burdens are produced for citizens when certain infrastructures are oversized when it comes to cost allocation. This can affect a sewage plant, waste incineration plant or even a hospital (allocated via the social security system). Indirect future burdens develop for the population when future state budgets are burdened, which can happen due to maintenance costs for infrastructure such as oversized airports, underused roads or half-empty schools.

Particularly hotly debated in the past 15 years are public–private partnership (PPP) models, which saw high current payments being made to state budgets (for example, in the form of availability payments, even if the use of infrastructure and accompanying fee income remained far below expectations). Motorways or road tunnels in relation to which the state's financial obligations to the private operator remain unchanged have achieved less than half the expected level of user fees. The private operator tends not to participate in the risk or the contract is drawn up to the detriment of the government that commissioned it. In particular in crisis periods it is important to select models in which future burdens on state budgets are avoided. In Portugal, for example, the PPP models of previous governments – such as that of Barroso – contributed significantly to the creeping deterioration of state finances.

8.6. Action Programmes to Combat Youth Unemployment

Since the beginning of the crisis, according to the relevant ILO statistics, youth unemployment has risen more strongly in the EU than in any other region of the world, totalling 26.5 per cent since 2008. While in Germany youth unemployment stands at 5.4 per cent, according to Eurostat it was 22.1 per cent in the EU as a whole in March 2012 and an enormous 46.4 per cent in Spain. Experience with a major crisis shows that young people across Europe remain the weakest group on the labour market because:

- in the crisis youth unemployment rises more rapidly than adult unemployment (Dietrich 2012: 19);

- the low qualified are much harder hit by unemployment (their unemployment level is almost 10 percentage points higher). In contrast to the 2000s a clearly »dichotomous« situation has developed in which the conditions for the well qualified have come closer to those of the medium qualified (in other words, they have deteriorated), while the gap between the medium qualified and the low qualified is greater than ever before (Dietrich 2012: 16).

A growth and investment programme can reduce youth unemployment in two ways (and thus go beyond the desire for increased mobility proclaimed in official EU programmes hitherto, which in the crisis countries leads to migration):

- on one hand, by making business start-ups easier for companies likely to employ well qualified young people and supporting new firms for longer periods;

- on the other hand, by boosting regional employment within the framework of regional development programmes.

Overall, these principles of action show how important it is to reduce the obstacles to growth and to enhance the effectiveness of growth measures themselves.

Abbreviations

AIG	American International Group (insurance group)
BDI	Bundesverband der Deutschen Industrie (Federation of German Industry)
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EIB	European Investment Bank
Eurostat	Statistical authority of the European Commission
ESM	European Stability Mechanism
HRE	Hypo Real Estate Bank
ILO	International Labour Organisation
IMF	International Monetary Fund
JESSICA	Joint European Support for Sustainable Investment in City Areas
JEREMIE	Joint European Resources for Micro to Medium Enterprises
kfw	Kreditanstalt für Wiederaufbau, Germany's largest development institution, majority shareholder the federal government, minority shareholders the *Länder*
SME	Small and medium-sized enterprises (independent and up to 250 employees)
OTC	Over The Counter: individual transactions not taking place on stock exchanges, used for so-called financial innovation
PPP	Public Private Partnership(s), partnerships between the state and private investors in project financing
RSFF	Risk Sharing Financing Facility for innovation and research in the EU
SVR	Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung – Council of Economic Experts

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