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A strategy for more investment, more growth and employment in Europe

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I. Time for a new strategy

With the election of Emmanuel Macron, a serious crisis for Europe has been averted in the nick of time. It would be wrong, however, to respond by continuing to pursue the present economic strategy for the euro area as if nothing had happened. The theory that the only route to more growth and more employment is through national spending cuts and reform efforts, which Germany has been propagating for years and which other countries have been forced to embrace, has been disproved both economically and politically. It is due to massive support from the European Central Bank that Member States have been protected from the brutal pressure of the financial markets and have enjoyed more fiscal flexibility again through the policy of low interest rates. That laid the foundations for an economic upturn, which was not sufficient, however, to impact on the job market, as is illustrated by the alarmingly high rates of youth unemployment in many EU countries. The only Member State that has still been given no respite from fiscal consolidation is Greece. This is duly reflected in the weakness of the economic recovery there.

The election of President Emmanuel Macron in France presents an opportunity to adopt a new strategy for the restoration of full employment and competitiveness in Europe. Its focus must be on countries working together to resolve the problems of the euro area instead of trying to go it alone. As a basis for this communal effort we propose a European investment programme. It should be designed to generate, over a five-year period, €500 billion in additional investments, which is equivalent to one per cent of the eurozone GDP per annum. If Member States outside the euro area are prepared to join in, an increase in investment activity would benefit them too. With a continuing wealth of spare capacity and interest rates close to zero, it may be assumed that the multiplier effect of such expenditure would be well in excess of 1:1.

Our proposal provides for fixed-term Community funding of investments, particularly by means of an extension and realignment of the Juncker Plan and the creation of a separate budget for the euro area amounting to €30 billion a year. In addition, scope would be created in the Stability and Growth Pact for additional loan-funded public investments amounting to 0.5% of GDP. To this end, it would be useful – as the new French President has proposed – to make the borrowing a Community matter to a limited extent by introducing Eurobonds. Such common government bonds make sense, because they can keep the interest rate stable for economically weaker countries too.

Investments, however, are not an end in themselves. They serve to promote sustainability, to improve communal provision of services of general interest and of infrastructure, to foster European solidarity and to create jobs.

The impact of investments on jobs may be estimated as follows: if investments inject an amount corresponding to one per cent of GDP, the multiplier effect is likely to boost GDP by 1.5% to 2%, depending on the prevailing cyclical conditions. In good conditions the increase in GDP is more likely to be on the lower side. In short, a gain of about 1.5% may be expected as a minimum. If productive capacity is being underused, higher demand leads to fuller use of capacity, which increases the productivity of the labour force. If productivity increased by about one per cent, this would generate a 0.5% rise in employment. Applied to the whole of the EU, this rise would correspond to some 1.2 million additional jobs.

More growth and a tangible drop in unemployment, particularly in countries such as Spain and Greece but also in France, would be the best way to ensure that the public no longer regarded Europe and the euro simply as imposing unwanted flexibility but also as engines of prosperity for everyone and hence sources of political stability.

II. Priorities of the investment programme

The following are the primary objectives of the investment programme we are proposing:

- to promote sustainable economic development, particularly through investments in renewable energy sources and energy efficiency,
- to create new jobs,
- to reinforce European solidarity,
- to heal divisions within and between European societies, and
- to bring tangible and fairly rapid improvements to people's living standards.

These objectives can be achieved first and foremost by means of investments in education, housing construction, local transport, the environment, health, culture and, last but not least, public safety. For this reason, the investment programme should focus on the local level. Consideration must also be given to development of the European transport networks. All of these investments can be expected to yield a macroeconomic return that is far in excess of current interest rates for long-term public borrowing.

With its local emphasis, the investment programme offers the opportunity for multi-stakeholder governance, in other words enabling people to identify more closely with

Europe through participation in decision-making processes. In this way, European integration could be reinforced horizontally, i.e. in the form of cooperation between municipalities and regions. The programme could thus offer a constructive alternative to the sterile choice between centralisation of power in Brussels and renationalisation of sovereignty.

It would require easier access to funding from EU programmes in order to lower the obstacles faced by local authorities. The current funding system for local and regional authorities, which depends on individual projects being put out to tender, is dauntingly cumbersome. That is one of the main reasons why many funding allocations are not being used. Funding procedures should therefore be devised from the perspective of local authorities. Wherever possible, finance for development and investment projects with diverse thematic orientations should be obtainable by means of a standardised and therefore less costly 'holistic' application procedure.

There are certainly national and regional development banks which offer advisory and executive services. They take care of the cost of applications, provide for cofinancing and ensure that the available funding is sufficient as well as compiling reports and providing the funding recipients – 'final beneficiaries' in EU terminology – with simplified access to EU resources. Accordingly, the advisory and pooling activities of the development banks would be intensified in the short term.

In the medium term, however, the aim must go beyond merely coping better and more efficiently with a cumbersome system that is 'shielded' by high barriers. The system must be designed more openly and simply, particularly for applications submitted by local authorities or by initiative groups from civil society.

III. **Funding the investment programme through a separate eurozone budget**

So that the investment programme can be rapidly implemented, it would be based as far as possible on existing funding procedures. Given the greater Community funding of the investment programme, however, a very conscious effort must also be made to signal a new beginning. To this end, it will be necessary, particularly in Germany, to overcome formidable **communicative and psychological obstacles. It must be made clear that a monetary union formed by countries whose economies vary in strength and performance cannot survive in the long term without financial compensatory mechanisms and that such compensation ultimately serves the interests of all Europeans.**

Germany's Foreign Minister Sigmar Gabriel, speaking in Berlin on 16 March 2017 in a discussion forum with philosopher Jürgen Habermas and Emmanuel Macron, rightly pointed out that Germany clearly benefited from the euro when all was said and done and should therefore regard itself first and foremost as a net beneficiary within the EU. For this reason, he argued, the time had come to begin emphasising, in the forthcoming Bundestag election campaign, that Germany was prepared to invest more in Europe than the agreed one per cent of GDP. Germany should even be willing, he said, to be the only state to do this, if need be, or to do it together with others, but the same commitment should not be required of all Member States. The provocative statement "We are prepared to pay more" was the only way to generate a debate on the reasons why everyone ought to have a shared interest in Europe.

For this reason, a new separate budget should be established for the euro area to fund the investment programme we are proposing. That is consistent with the logic underlying the single currency area, which has hitherto been focused exclusively on monetary integration and is therefore in urgent need of broadening to encompass elements of fiscal integration. In the past, it has been politically taboo to discuss the desire of the German Government and of Germany's MEPs to have the **whole of the EU** participate in the deliberations on a budget for the euro area and its disbursement, particularly as a concession to the United Kingdom. At a time when a desire to renationalise EU powers is inducing some, not only in the UK, to portray Europe as the 'root of all evil' and to contest its benefits, often against their better judgement, it makes perfect sense to create a budget for the **euro area** to support investments in the countries belonging to it.

According to the European Treaties, the euro is the standard currency of the EU. Some countries have not yet introduced the euro or have reserved the right to envisage a long-term future without the euro. These, however, are the exception, not the rule. It is therefore logical that decisions on investments in the euro area from this budget should be made by eurozone countries alone.

To implement the investment programme, provision would have to be made for an annual amount of some 30 billion euros for the separate eurozone budget. **For Germany, this would entail a contribution of about nine billion euros per annum, corresponding to 0.3% of German GDP.** Between five and ten million euros of this budget should be devoted each year to employability measures, prioritising the reduction of youth unemployment and jobs for young people in municipal capital projects, while the remaining 20 to 25 billion euros should be invested in those municipal projects, particularly for school and housing construction, local transport and hospitals, as well as in enhancing the public service, developing the water and energy infrastructure and planning and creating public spaces.

A number of these capital projects are conducive to partial self-financing. More than half of the cost of local public transport projects, for example, can be met from the transport operators' own revenue. For these projects, provision should be made for the local authorities to be able to reinvest the operators' share of the funding in future capital projects. In this way, EU projects can generate additional capital projects.

This may be illustrated by the following example: the rapid integration of all groups of migrants, including refugees, depends partly on their freedom to become self-employed and start up their own business. Such start-ups could be underwritten and supported by means of public loans. The volume of repayments will depend on the ratio of successful to unsuccessful ventures. In the best-case scenario the fund will remain undiminished and can then be reused for a second, third and even fourth round of start-up loans to new enterprising refugees.

The amount of municipal cofinancing will determine the amount by which the volume of investment exceeds the actual budget. A cofinancing rate of 20-50% seems realistic. If we assume an average rate of one third, the dedicated budget of €30 billion will yield a total investment volume of €40 billion.

In the regions with the weakest economies, however, local authorities are often unable to cofinance projects from their own resources. An option should be created for these authorities **to use monies from other sources, such as the European Structural Funds, to cofinance projects.**

IV. An extended and improved Juncker Plan

The largest element of the investment initiative in terms of volume would be an improved and extended Juncker Plan. It should be altered in such a way that a larger proportion of investment proposals are implemented in future in those countries which currently suffer from particularly low levels of investment and growth and in which the funding environment is particularly unfavourable because of high country risk premiums. More support should also be given to investments in areas where returns are low for individual businesses but high for society as a whole.

The weakness of the Juncker Plan lay in the fact that, in its first three years, it has essentially pursued the right goal of more investments but without committing budgetary funds on a significant scale. For that reason, it has been focused on projects with very high leverage potential. The architects of the plan envisaged that very limited public support funding of 21 billion euros could elicit 15 times that amount in private or public investments.

Such leverage, however, has only been obtainable in the case of projects with very high returns on investment. Moreover, many public investment projects have been excluded from funding under the Juncker Plan because the public authorities of countries in crisis have had no leeway to incur new debt.

Accordingly, when it comes to infrastructural investments, the Juncker Plan has an in-built bias towards either privately funded projects or to projects based on a public-private partnership (PPP). Experience of PPP projects, however, has been discouraging in most cases, because future burdens and the lion’s share of the risk have been offloaded onto the public treasury.

A second problem with the Juncker Plan lies in the fact that a large percentage of the funding has flowed into those very countries, such as Germany and the United Kingdom, where there is no shortage of affordable finance on the market.

To correct these defects, the Juncker Plan should be extended and focused on the following two areas:

- investments that tend to exert little leverage but pursue socially important objectives such as energy saving, energy networks, energy efficiency in production processes, municipal investments and investments in small and medium-sized enterprises, and
- innovation funding that is likely to generate a great deal of leverage.

Even when the first Juncker Plan was being negotiated, the European Parliament was already focusing on investments which were less profitable in purely economic terms but which were socially beneficial and cost-effective. The compromise reached at that time was that national and regional platforms could be created to fund projects devoted to goals such as energy efficiency and that a single injection of state funding could be made available for such projects. It is possible to build on that compromise in order to establish an extended and improved Juncker Plan.

If such a recast plan is to be a key component of an investment programme, it is important that the EU Member States and the European Parliament reach consensus on the principle that budgetary allocations should be made as a

matter of priority for investments in those member countries where investment rates are lowest.

The extended and improved Juncker Plan could be topped up through an increase in the EIB lending facility, which, with the given equity ratio, could increase the volume of credit by some 30 billion euros over the historical base level of 50 billion euros a year that existed prior to the financial crisis. Budgetary resources of some eight billion euros a year would also be needed, however, to cover the necessary grant element as well as potential loan defaults.

Although such an amended Juncker Plan would achieve far less leverage than the 15:1 ratio that was originally targeted, it would have the advantage of channelling investments in a considerably more targeted manner into sectors and countries where they would yield particularly ample social benefits. These components of the investment plan are likely to generate an additional investment volume of 58 billion euros, which corresponds to a leverage effect of slightly less than 2:1.

V. Mobilising local authorities for integration and development

As regards migration to Europe, local authorities find themselves in widely diverse situations. The crucial task is to provide a better financial framework for the municipalities that are willing to accept the associated challenge with all its difficulties but also with the opportunities it offers. This applies especially to the integration of migrants into the labour force, wealth creation, educational establishments and the creation of new businesses.

From the integration of refugees after the Second World War, Germany can learn that the opportunity to start their own businesses is a particularly important condition for the integration of migrants and for the economic success of the integration process. For decades this was the task of the German Equalisation Bank (DtA), a development bank that was later subsumed into the KfW (Kreditanstalt für Wiederaufbau – Reconstruction Loan Corporation), and of the regional development banks. Global experience of internal and cross-border migratory movements over the past few decades has also testified to this beneficial effect.

An initial step may be to open the current European programmes to such municipal initiatives. In the ever-increasing number of countries where there are development banks, these banks can be instructed to assist in making applications wherever that may be necessary. Practically all development banks are involved in the implementation of programmes for SMEs (small and medium-sized enterprises) and may therefore be regarded as natural partners. Member States can also take initiatives that enable development banks to pool smaller projects and administer their accounts under a collective heading, as is customary in the case of projects for SMEs. In the EU framework, a special request may be made to the technical assistance partnership Jaspers – Joint Assistance to Support Projects in European Regions – to make itself available to provide relevant advice in areas where no development banks exist.

VI. Temporarily boosting investment by means of European Commission borrowing

Only in a few exceptional cases is the European Commission permitted to take out loans to top up its budget. There are certainly precedents, however, the purpose of

such past borrowing being the stabilisation of Member States' economies through the European Financial Stabilisation Mechanism (EFSM). The EFSM, a Community instrument of the EU established by Regulation (EU) No 407/2010, contributed €60 billion a year from the EU budget from 2010 as a one-off temporary measure. During the financial crisis, it was replenished twice on the basis of decisions adopted jointly by the Member States. This can be done again, given that Germany subscribed to those replenishment decisions. Fixed-term borrowing by the EU of ten billion euros a year for four years can provide for Community-funded investments without impacting on national budgets or national debt levels. As was outlined with regard to the euro area in section IV above, more funding can be made available for municipal investment projects throughout the EU. This facility for the entire EU will thus complement or reinforce the facility for the euro area. Part of it will benefit the eurozone countries, and part will benefit the non-euro countries.

VII. Widening national discretion as a way out of the crisis – a new 'golden rule'

Some years ago, the former European Commissioner and Italian Prime Minister Mario Monti called for a kind of 'golden rule' for the euro area that would enable states to borrow for investment purposes. It would allow Member States to fund additional investments by means of loans, at least for a limited time.

In view of the years of neglected public investment, we propose that Member States be given, over a five-year period, an annual margin of discretion under the Stability and Growth Pact for this purpose amounting to 0.5% of their national GDP.

Consideration should be given, moreover, to the question whether and to what extent improvements in the estimation of the euro countries' structural deficits could create more scope for investment funding. There is a body of evidence indicating that, after years of extremely weak growth, the calculation methods are resulting in a systematic overestimation of those deficits. The present calculations for Italy, for example, show that the economy is working close to full capacity, even though Italy's GDP is about five per cent below its pre-crisis level. For this reason, the entire Italian deficit is deemed to be structural. Under the rules of the Fiscal Compact, it must therefore be reduced by half a percentage point each year by means of additional consolidation measures. It is therefore advisable to review the estimation method and correct it as necessary. For countries with high unemployment and persistent weak growth, such correction could create additional leeway within the Stability and Growth Pact for national investment borrowing.

The funding opportunities amounting to some €50 billion created by the temporary introduction of the 'golden rule' will probably not be used to the full by all Member States. That is likely to be the case for Germany in particular. We therefore impute an actual additional investment volume of about €35 billion a year.

A key objective of the investment programme must be to reduce the economic gap between the countries in the heart of Europe and those on the periphery. In particular, there is a need to rebuild production capacities and to reinforce or reinvigorate services of general economic interest in those countries that have been hit especially hard by the crisis. To this end, a system of indicators should ensure that 75% of the funds from the investment programme are available to the economically weakest countries and regions and 25% to the structurally weak regions of the countries in the heart of Europe.

Measures financed with resources from this investment programme should be exempted, though only for the term of the programme, from internal-market rules such as the provisions governing state aid and public procurement. This will permit selective support for individual public or private businesses and help to establish or re-establish production systems and value chains. Allowing the stipulation of local content as a condition for awarding contracts will also serve this purpose.

VIII. Conclusion and tabular summary

Our proposal would be a first major step towards counteracting the present danger of gradual disintegration of the EU. What matters is not that all measures be executed in exactly the way described above. What is important is that the alternative to the present course should be made visible and be adequately resourced. That can be done.

The proposals made by the newly elected President of France, Emmanuel Macron, for a European investment programme and a separate budget for the euro area present an opportunity for a joint Franco-German initiative. Our political responsibility demands that we join with President Macron and seize this opportunity quickly and boldly.

The funding structure may be summarised as follows:

	Annual investment volume	**Annual budgetary requirement**	**Estimated annual German share**
Extended and improved Juncker Plan	€58bn (for 4 years)	€8bn	Included in EU budget
Eurozone budget	€40bn	€30bn	€7.5bn
European Commission (borrowing for investments in the entire EU)	€13bn (for 4 years)	€10bn	To be repaid from future EU budgets
Golden rule in the Fiscal Compact for Member States	up to €50bn (excl. leverage effect, max. 5 years)	- (EU budget not involved)	Germany will presumably not avail itself of this funding

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