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# A new industrial policy for a dynamic, social and ecological Europe

EAEPE Symposium 2016, The role of industrial policy in European re-industrialisation

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Krakow, May 12<sup>th</sup>, 2016

- A new strategy for Europe
- Vision, benchmark, goals
- Principles and drivers of change
- Redefining industrial policy and competitiveness
- US vs. Europe: testing the new definitions
- Summary

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- Unification of Europe: 28 members (+10); peace project
  - Catching-up of Eastern Europe
  - No external deficit (in contrast to US)
  - Larger manufacturing sector, stronger Euro (relative to 2000) \*
  - Low dynamics, high youth unemployment (20%)
  - National priorities and preference override common goals
  - Financial markets focus on problems and exaggerate them
  - Ignoring neighbours (Turkey/Ukraine/North Africa) \*

⇒ Reassessing the European strategy needed.

2010 - 2025

EU 28

1.5% – 1.8%

USA

2% – 2,5%

Japan

1% – 1,5%

China

5% – 7%

World

3.5% \*

⇒ EU 28 between 1% and 2%

⇒ Definitely less than before 2-3%

⇒ Growth differential towards US.

Europe needs to become more **dynamic**,  
social inclusive and **ecological sustainable**

- **Welfare, Wealth, Work, 2012/16 7th Framework Programme**

- WIFO (Coordinator) plus 32 partners, 4 years

- Executive Summary: <http://Synthesis-Summary.foreurope.eu>

- Synthese: <http://Synthesis-Report-Part-I.foreurope.eu>

- 160+ Papers <http://www.foreurope.eu/>

Aiginger, K., New Dynamics for Europe: Reaping the Benefits of Socio-ecological Transition. Part I: Synthesis, WWWforEurope Synthesis Report, Final Version, Vienna, Brussels, 2016..

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- Europe as role model for successful regions 2050:
  - Stronger **dynamics** based on innovation and human capital
  - **Less differences** in incomes, higher employment
  - World leader in environmental **technology**
  - **Stable** due to a modern, regulated financial system
  - Heterogeneous **preferences, pluralistic**
  - Open area, **enjoying globalization**; inviting neighbours

⇒ **A genuine European model of wellbeing**

⇒ **Different from US model and Asian models.**

- 
- Vision starts from goals not from problems
  - Fiscal consolidation is necessary, but not sufficient; dynamics, employment plus sustainability are the goals
  - Taxing financial transactions supports the real economy
  - Distribution matters for growth and stability
  - 20% youth unemployment is intolerable
  - Europe has to deal with - and enjoy - internal heterogeneity
- ⇒ The growth path will be less steep than before
- ⇒ The welfare content of growth increasing.



- The vision calls for a new benchmark of success
  - High and rising Wellbeing
- This benchmark **substitutes** GDP and GDP growth
- Theoretical underpinning: **Beyond GDP concept**
  - Stiglitz – Sen – Fitoussi Commission 2009
- Operationalisations
  - Three strategic goals
  - With objectives within each goal
  - Measurable by Better life indicators OECD, EU.

## Three strategic goals

- Economic dynamics
- Social inclusiveness
- Ecological sustainability

⇒ The three goals have the same priority

- Each goal is underpinned with sub-goals
- Measurable by Better Life Indicators.

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- **Simultaneity** between goals and instruments
    - Instead of silo strategies
    - Isolated strategies are expensive and inefficient
  - **High-Road-Strategy**
    - Forfeiting low costs and standards
    - Based on capabilities, ambitions
  - **Two-stage strategy**
    1. Consolidation and reprogramming (restarting growth)
    2. Socio-ecological transition: low or long-run growth
- ⇒ **First stage not** business as usual  
but investment in change.

- 
- **Productivity** more important than costs
    - Enlightened version of cost competitiveness:
  - **Competitive advantage:**
    - Quality, sophisticated products, **technology**
  - **Growth drivers:**
    - Innovation, education, universities
  - **Ambitions/Institutions:**
    - Social empowerment, ecological excellence, trust
  - **Objectives: Beyond-GDP goals in general**
- ⇒ Europe has to go for a high road strategy.

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

- New **infrastructure** much less dependent on fossils
- **Social** innovations prepare for second stage
- Changing institutions, **behaviour**, awareness
- Redefine competitiveness towards **beyond-GDP** goals
- Reduce dominance of GDP, address **goals directly**
- Start **double** decoupling (emissions **and** labour)
- Support **industry** moving towards **4.0** (lower material/ energy)

⇒ Energy Roadmap 2050

⇒ Zero Net Emission Goal (OECD, COP 21 Paris 2015).

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



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- Inroads of emerging countries (China no. 1 manufacturing)
- Declining shares of manufacturing ( $\Rightarrow$  10% / 15%)
- Finance sector catches up (US) or forges ahead (UK) <sup>1</sup>
- Crises of countries with low share & trade deficit

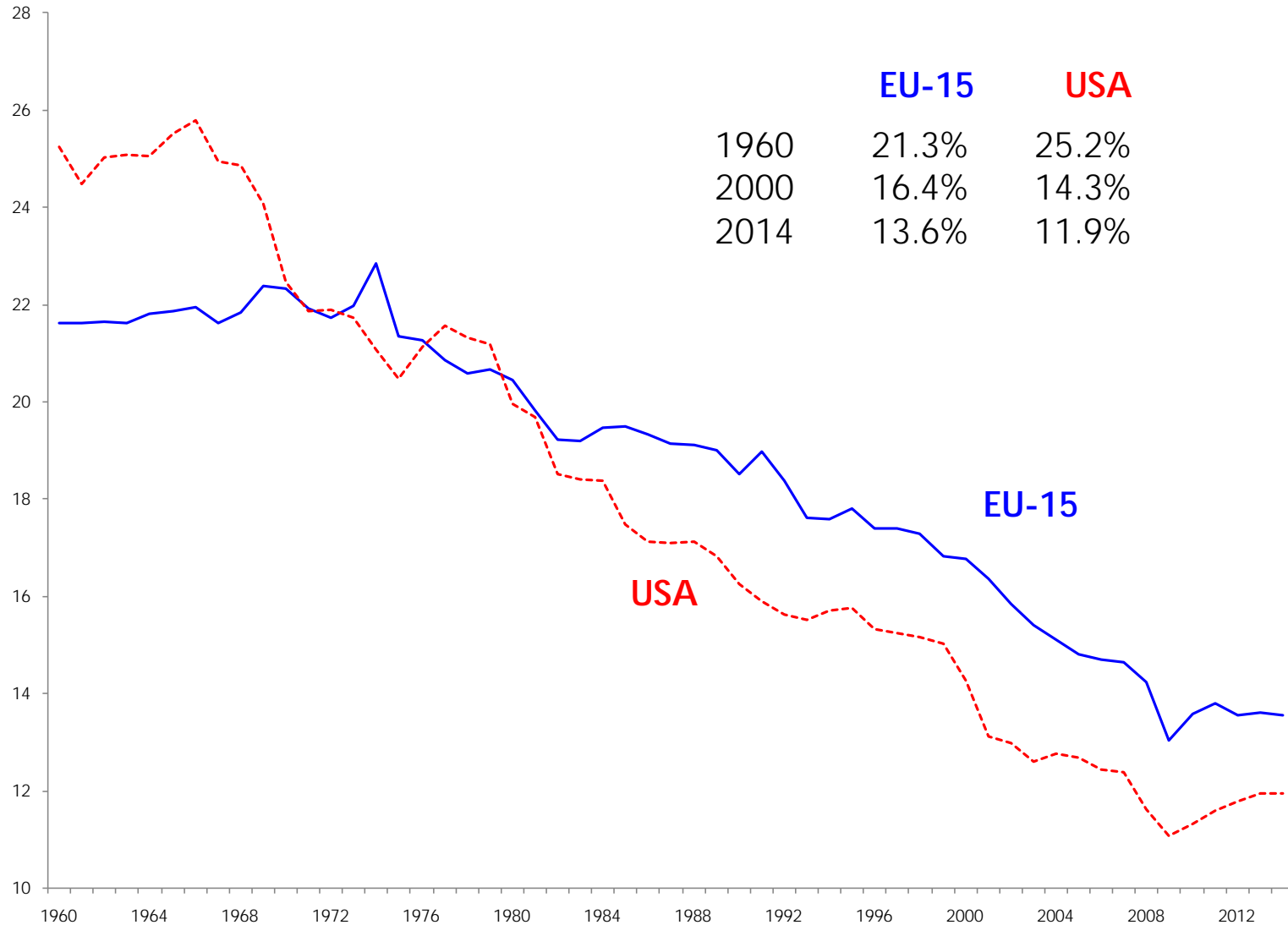
$\Rightarrow$  Low growth of GDP

$\Rightarrow$  Importance of manufacturing for R&D

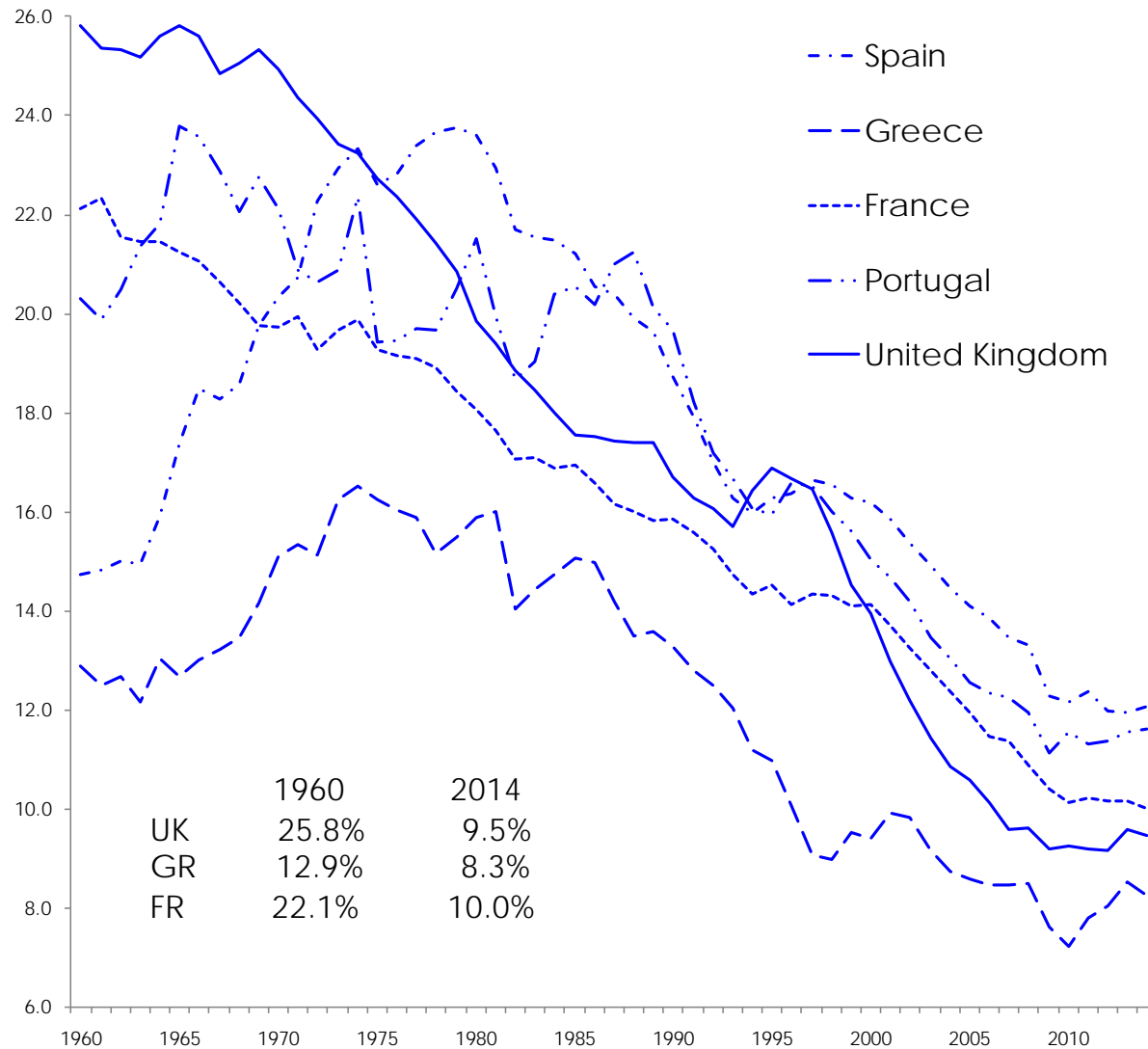
$\Rightarrow$  Societal challenges (social, ecological, health).

<sup>1</sup> UK: manufacturing 9%, financial sector 14%.

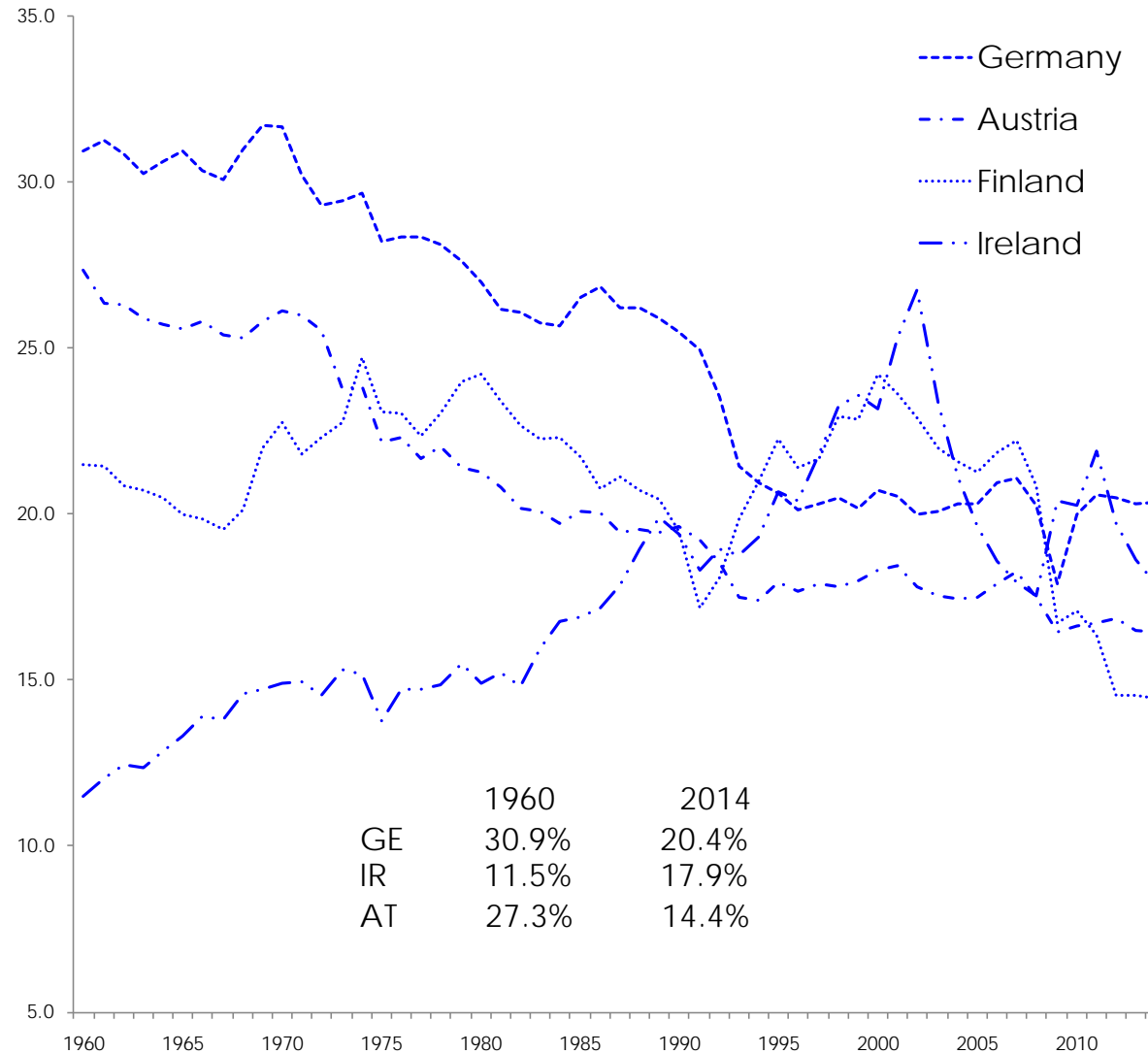
# The share of manufacturing in GDP: larger in Europe than in US (at current prices)



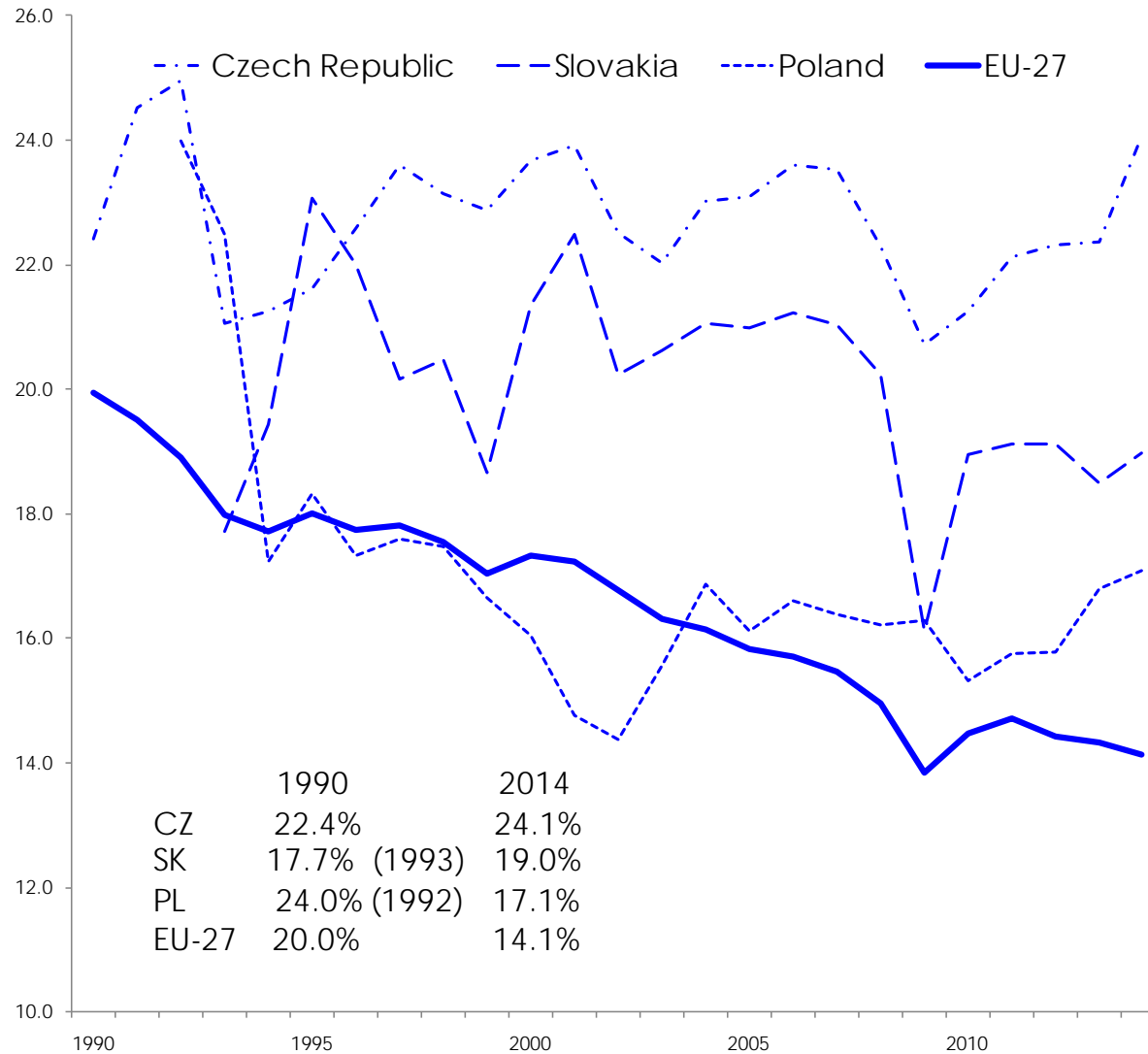
# The share of manufacturing shrinks toward 10% or less: Greece, France, UK



# Share of manufacturing still about 15% or more: Germany, Ireland



# Share of manufacturing higher in new members: CZ, SK, Poland (17%)



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- Subsidies for **ailing** industries
  - Tax exception for **energy-intensive** firms
  - Creating and supporting of national **champions**
  - Preference for **large firms** (often semi-public)
  - Emphasis on **energy** sector, **transport**, basic goods

⇒ Decelerating structural change

⇒ Decline of manufacturing in GDP to 10 % (UK, GR).

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Proposals by academic (Aghion, Rodrik, Aiginger, etc.)

- Support of **market** forces (not fighting against)
- Foster **competition**, not single large firms
- **Broad** technologies, not picking out one winner
- Support goals with **long-term** interest of **society**
- Based on **education and innovation**
- **Systemic**, not fragmented policy strands

⇒ Promoting change

⇒ Connected with societal goals.



# WIFO ■ Traditional concepts of competitiveness: cost focus

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- Price competitiveness: Simple version
    - Low wages, energy costs
    - Weak social and ecological standards
  - Enlightened version of price competitiveness:
    - Low unit labour costs (incl. productivity)
  - If output is included in assessment (“outcome” competitiveness)
    - Current account, GDP, GDP/capita, employment
- ⇒ Focus on low cost, taxes, standards
- ⇒ Used by media, not connected to welfare.

- “The ability of an economy to provide beyond GDP goals”**
- Outcome: measured by 'better life indicators' (OECD)
  - Drivers specifically for industrialized countries: **five capabilities**
    - Education, innovation, institutions
    - Activating social system, ecological ambition
- ⇒ Extension of definitions like **“income + employment”**, **“Welfare creation”** (used by OECD, EU in the 1990s)
- ⇒ **A long way from the old “Krugman-critique”** (“dangerous”, “misleading”; 1991) **to Beyond GDP-Indicator.**

Aiginger, K., Bärenthaler-Sieber, S., Vogel, J., Competitiveness under New Perspectives, WWWforEurope Working Paper no 44, October 2013.

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## ■ Low road path:

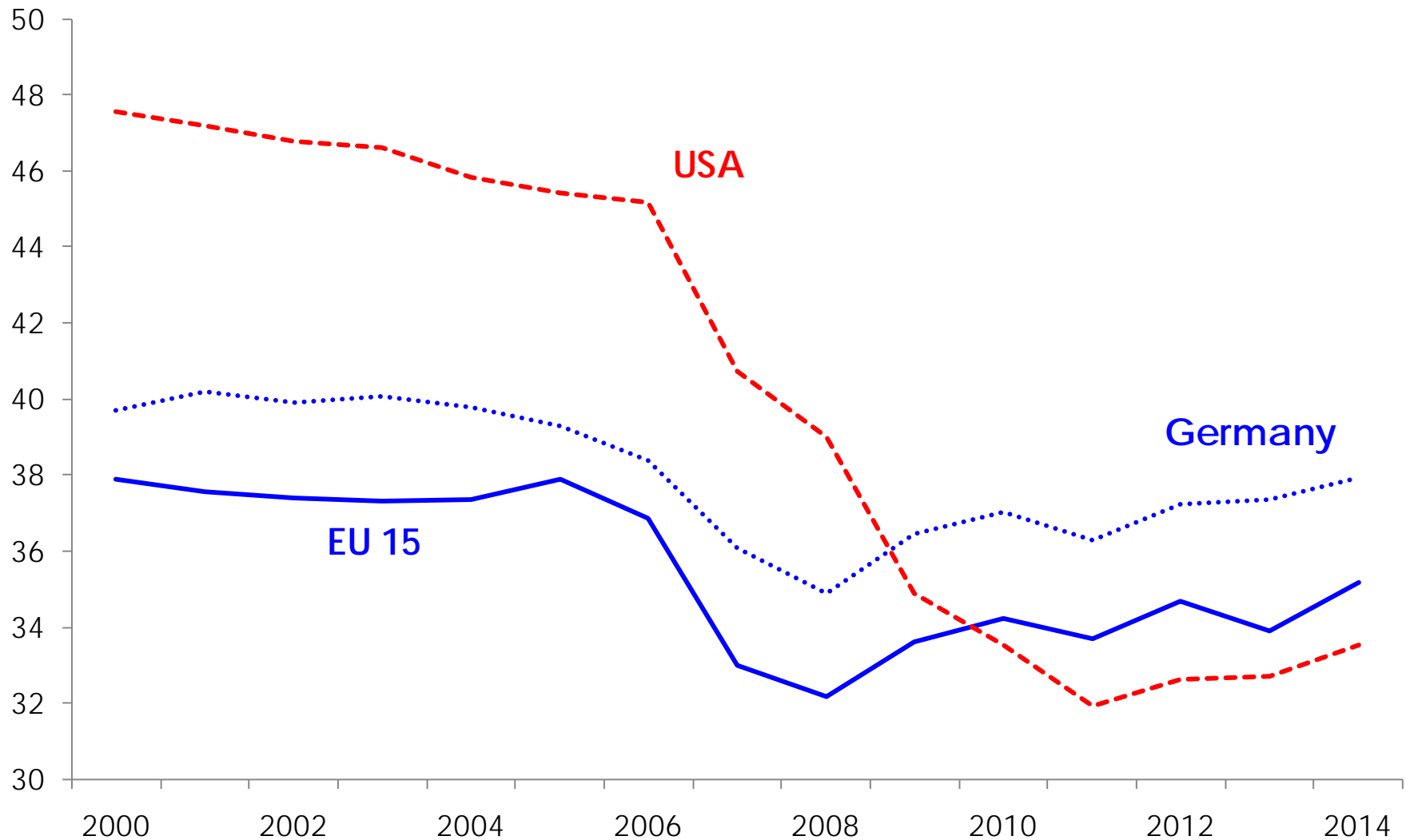
- Calling for low wages, standards
- Hailing cheap gas (fracking)
- Defying carbon pricing (taxes)
- Calling for emerging countries to start with CO2 cutting

## ■ High road path (EU 2020, Roadmap 2050, MIT, 2013):

- Climbing up the quality ladder: education, innovation
- Providing capabilities, “new” industrial policy
- Convening, coordination, risk pooling & reduction
- Consider societal goals in industrial strategy.

- Visible problems
  - Strong decline of manufacturing
  - High deficit in trade and current account
- Deeper problems (neglected in US discussion)
  - Technology leader: **surplus** in energy-intensive industries
  - Rising **deficit** in technology driven industries
  - Early outsourcing – strong firms, no US production
  - **“US firms are alone at home”** (low cooperation, MIT).

# Share of technology driven industries in total exports: from 50% to 33%



- US restarts to grow a little bit faster
  - with some positive spillovers (demand, unemployment)
- US will become the largest exporter of fossil energy
- US increases its trade surplus in energy-intensive products
- Persistence of deficit in technology-driven industries
- Life time of fossil energy extended (with cleaner version: gas)
- Investment in renewables discouraged in EU and US
- Spillovers of clean technology to emerging countries reduced.

- Energy prices are falling, price difference US/Europe increases
  - US coal is exported to EU, CO2 emissions in Germany increase
  - EU industrial policy **forgets** emission trading, energy taxes
  - Market for renewables in trouble: economically, politically
  - Europe **abandons** strategy for “sustainability at the centre stage”
  - Return to the old concept of “cost” competitiveness
- ⇒ The Krugman critique “dangerous & misleading” is justified 20 years after its publication.



- Financial stability: resilience, restart growth
- Reducing unemployment and income spread
- Absolute decoupling of material and fossil energy
- Limiting size of government (50% of economy)
- Transparency and accountability as driver
- Paying attention to income distribution
- Openness, entrepreneurship, diversity, choices

⇒ WWWforEurope (<http://www.foreurope.eu/>).

- Leadership in clean technologies/energy efficiency
  - Export these technologies to emerging economies
  - Close deficit in R&D, top universities, key technologies
  - Call for and invest in raising standards in emerging economies
  - If there is a cost disadvantage (e.g. in energy prices) overcompensate it by a bonus in education, research
- ⇒ Sweden, Denmark demonstrate that such a strategy can be successful.

- **Europe** closes deficit in R&D, top universities, lead technologies
- US enforce energy efficiency (today 50% lower than in Europe)
- **All countries** agree on long-term goals for climate (Paris 2015)
- Countries compete by instruments/technologies for renewables
- **All countries** go for social and ecological innovations
  - with different speed given by income, capabilities, preferences
  - but agreeing on long-term goals: carbon emissions down by 80%
  - highest energy efficiency, use of best technology in FDI
  - Market-based pricing of externalities, technology transfer.

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- Ecological sustainability; climate policy
- Reduced poverty and unemployment
- High incomes pay high taxes
- Transparency, less corruption as a growth driver
- Fair taxes; smart government, fighting tax erosion
- Choices, openness, mobility.

- From GDP ⇒ **broader goals** as performance benchmark)
  - ⇒ Dynamics, social inclusiveness, sustainability
- From competitiveness as low costs
  - ⇒ Capabilities delivering goals
- From isolated industrial policy favouring old structures
  - ⇒ Systemic policy supporting high road competitiveness

**Europe can succeed only by a high-road industrial policy**  
⇒ **Delivering dynamics, inclusion and sustainability.**

- Ecological sustainability; climate policy
- Reduced poverty and unemployment
- High incomes pay high taxes
- Transparency, less corruption as a growth driver
- Fair taxes; smart government

The strategy is based on

- Choices, openness, mobility, global cooperation

⇒ High-road strategies on a new industrial policy deliver Beyond GDP goals.

- EU: 'not in a good state': economically, public opinion
  - Driven by problems: banking, Greece, Brexit, refugees
  - Populism will phase out if there is a shared vision
    - dynamics, employment, lead in decarbonisation
  - Europe will become a success model again
    - needs a new strategy and
    - investment into change
    - exchange with neighbours (Fulbright, ERP)
- ⇒ Europe can become the best model for dynamic high-income regions.





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- **Horizontal differences** are welcomed and necessary
    - Which source of renewable energy, of “intermediate technology”
    - Competition increases innovation
    - Differences in goals according to preferences are necessary
  - **Vertical differences** for countries with different incomes
    - But limited within the same income group (US, Europe, Japan)
  - **But consensus needed about the long run**
    - What solves long-run problems, what provides short-term benefits
    - What destroys positive development in other regions
- ⇒ **Maximum agreement about long-run path increases welfare within and across groups.**

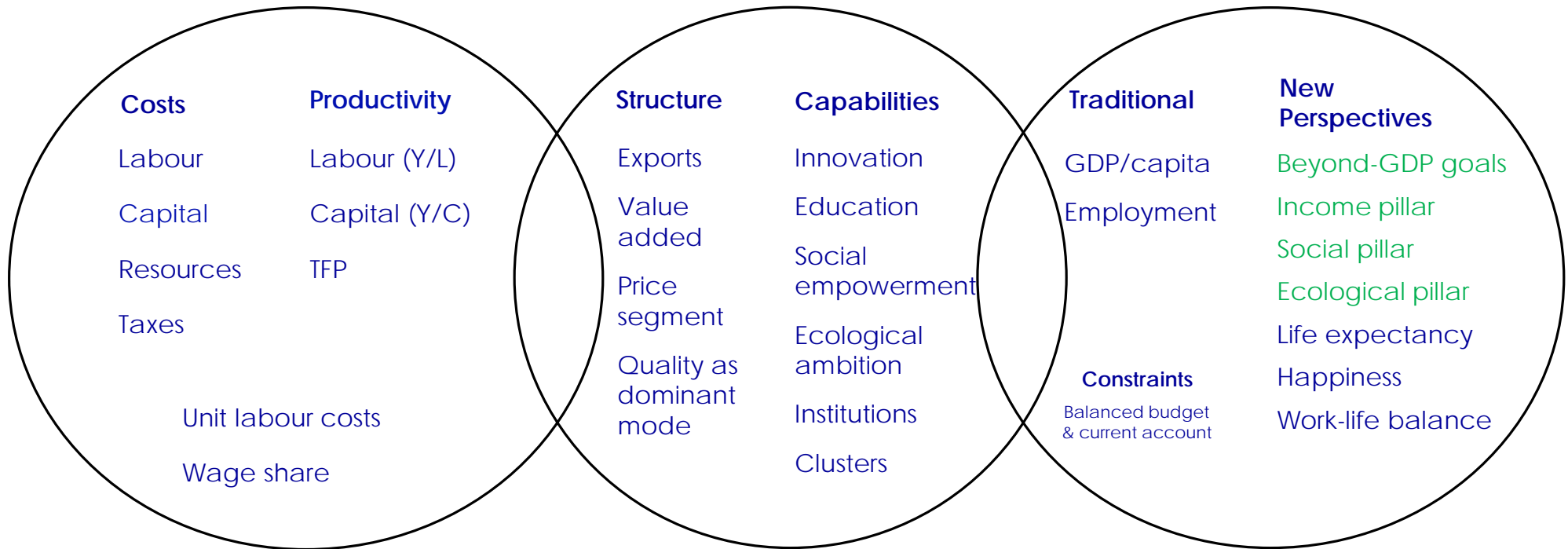
- Fossil energy at any costs (fracking with known technologies)
  - "Security" of energy supply
  - Subsidies for fossil energy larger than for renewables
  - Breaking down of emission trading (Europe, Australia)
  - Tax free kerosene for airplanes, low transport cost
- ⇒ "Emerging countries should start with energy saving"  
(excuse for policy inactivity of US and EU)
- ⇒ "Europe is responsible only for 10% of emissions".

# WWWforEurope concept: Competitiveness in a nutshell

*Price competitiveness*

*Quality competitiveness*

*Outcomes competitiveness*



*Input-oriented evaluation*



*Outcomes-oriented evaluation*

## A plethora of traditional definitions:

- Sectoral policies (defence, high tech); national champions
- Horizontal, broad activities, general conditions
- Clusters, activities, regional centres, etc.

**Industrial policy (for high income countries)**

**Measures to promote (high road) competitiveness**

- Industries and services
- Systemic i.e. integrating industrial + innovation policy
- Driven by societal goals (Beyond GDP).

- To stay competitive with the US, Europe has to **match US in energy prices**
    - And stagnating median wage
  - US-policy sets limits to:
    - Higher taxes/standards
    - Reestablishment of emission trading
    - Progress of alternative energies
- ⇒ **High wage countries, Beyond GDP strategies can never succeed by low energy prices.**