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In search of growth

With deep crisis weakening potential output growth, the need for an explicit growth policy is emerging most starkly in Japan, the EU and the US. If properly shaped, this will help to consolidate budgets and restore world economic equilibrium.

Even in times of fiscal consolidation and restricted scope for monetary policy, potential still exists for reforms that will foster growth. Some bolster consolidation; others call for clear-cut priority setting, and most have a positive impact in the medium term. To weather the present plight, coordinated international, European and national reform packages are imperative. Their collective stimulus could then make itself felt and help consolidation work.

Internationally, the greatest opportunities so far have been passed up in trade and climate policy. Efforts must focus on bringing the Doha Round to a successful conclusion, on advancing significant free trade agreements and on setting up the right international climate diplomacy. Potential can also be leveraged by opening up to direct investment.

There would also be a possibility within the G20 framework of transforming the growth agenda into a work programme for privatisation, better regulation of product markets and the liberalisation of procurement markets.

In the European Union an agenda will need to be set for Community policies, first and foremost on expansion and enforcement of the internal market, on drawing up a growth-enhancing EU-budget and on improving the overall business environment.

The lion's share of growth promotion will presumably fall to national structural reforms. Requirements differ here:

In Europe many countries still face the task of thorough reform of their labour markets and social security systems in order to make better use of their potential. Higher investment in education, and reforms, are necessary in very many countries. Some southern European countries should also privatise state assets.

In the US, apart from various structural reforms with a fiscal dividend the most pressing issues are corrections to healthcare and considerably higher public sector investment. Substantial corrections to the tax system and the development of a consistent climate policy similarly belong on the agenda, but these are politically blocked, at least in the short term.

Japan should concern itself with opening up to direct investment, integration of the dual labour market, increasing productivity in services and SME businesses, promoting renewable energies and reform of the tax system.

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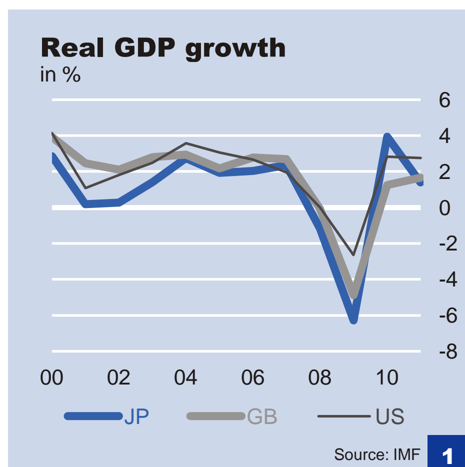
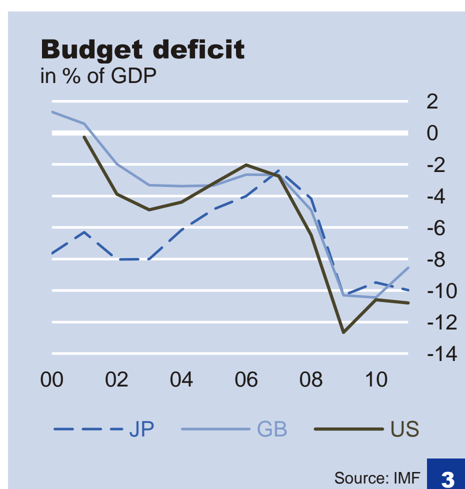
Consolidation and growth – can the two go together?





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The economic and financial crisis has weakened potential output growth in many afflicted countries. As upheaval persists, it is not yet clear how rapidly the slowdown in the sustainable growth rate can be brought under control. To compound the situation, the scope for fiscal and monetary policy stimulus is already severely restricted in many countries. Doubts about the effectiveness of cyclically motivated monetary and fiscal policies, or lack of political support for such measures, are already imposing political limits on activity for many governments. In practically all industrialised nations the forces driving growth therefore need to be strengthened with supply-side structural reforms.[1]

In this paper we examine what stage discussion has actually reached in the quest for potential growth-enhancing reforms. Special attention is paid to those areas that would not require any substantial additional resources but which could, instead, trigger an impact primarily through legal framework regulation and/or economic incentives.

The weaknesses in economic growth, measured in terms of per capita incomes, differ considerably within the traditional industrial countries.[2] In Japan and Canada high labour input per capita is accompanied by low productivity. The reverse is true in Germany, France and Spain. The United Kingdom delivers average performance and the US above-average. Economic policy measures should therefore place different emphasis. Numerous structural reforms to improve the chances of growth may also help reduce global economic disequilibria and lead countries onto a more balanced growth path.

High public sector debt in many countries will necessitate a sustained consolidation policy lasting many years[3], which in turn will limit the scope for measures to promote growth. The majority of countries must focus their consolidation efforts on curbing the general rise in spending, partly by cutting permanent expenditure, above all on public sector pay and government transfers, administrative activity itself and social security benefits. Also on the expenditure side, subsidy cuts still have the potential to create considerable additional leeway in many countries. Reductions in the US could be made in subsidised housing, agriculture and energy companies, in Japan mainly in agriculture and in Europe chiefly in agriculture and the energy sector. However, growth-enhancing spending on such important areas as education and public infrastructure should be spared any forthcoming cutbacks.[4]

But some countries also need to ramp up their tax receipts substantially; in most of them this should be achieved with steeper tax progression, a better balance between direct and indirect taxes, appreciable taxation of real estate assets and investment income, and by winding down subsidisation in the tax system. Tax enforcement problems are also evident in countries like Greece. What is more, a broader tax base is essential in many countries, not least among them the US. And certain countries – notably Greece,

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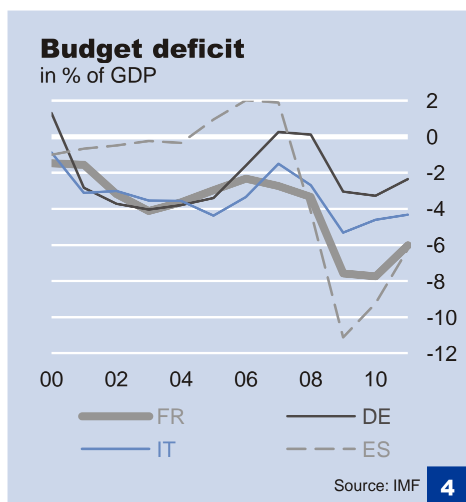
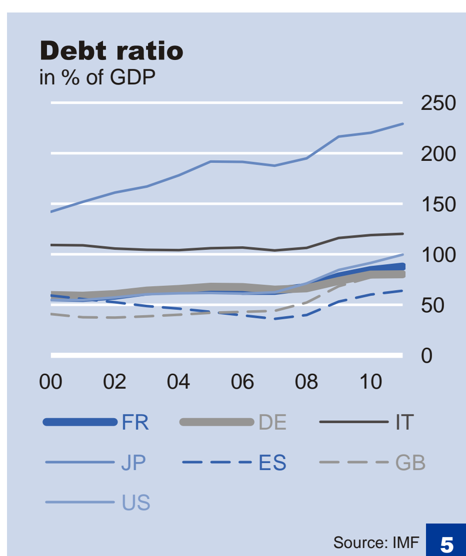
[1] IMF (2011).
[2] OECD (2011, 2010).
[3] Becker and von Rotberg (2011), Reinhart and Rogoff (2011, 2009).
[4] Becker et al. (2008).





Portugal and France – could still generate considerable fiscal and economic benefits by selling off state property.

There are, moreover, a whole host of growth-enhancing structural reforms that also help to consolidate public finances. These do not only consist of running down subsidies for corporates, farmers and energy consumption and the support granted to other economic groups in the form of transfer payments or tax subsidies. Rather, many southern European countries should also eliminate incentives in the social security and tax systems that send out the wrong signal to take early retirement and offer disincentives to take up employment in the first place. Efficiency drives in healthcare systems and in public administration in general are also warranted.

Some industrialised countries, mainly those with IMF programmes, have already instituted national structural reforms. But governments still have their work cut out at the international, European and national level to promote growth and employment, and this should be addressed in the near future. In the following we look back on various policy options that were sidelined in the boom years.

International dimension

Trade policy: Seize chances of more open markets

International economic policy in recent years has been guilty of neglecting the possibilities at its disposal to encourage the driving forces of growth. Instead of pushing ahead with targeted liberalisation of the markets for agricultural products, goods and services, since the outbreak of the economic crisis the big trading nations have intervened in free trade on many occasions.[5] Rapid conclusion of the Doha Round could trigger powerful impetus to growth in world trade and incomes in the order of up to a good half percent of GDP in the industrial nations.

Doha Round conclusion could add half a point to growth

Going forward, bilateral und inter-regional trade agreements could also provide further stimulus. The European Union is conspicuous here, negotiating free trade agreements with numerous trade partners encompassing more than half the EU's extra-regional trade. In the process of bilateral market opening these should bring in their wake new opportunities for the export industry and welfare and growth effects by intensifying competition and lowering prices. Meanwhile, in the US the free trade agreements with South Korea, Colombia and Panama were finally ratified. However, only a few multilateral talks on market opening are on track, most importantly the Trans-Pacific Partnership initiative and the EU-Canada free trade agreement. Japan, in turn, could benefit from both this initiative and from attempts to create a larger free trade area in Asia itself, as China, South Korea and Japan have recently signalled to do. Moves by Japan to open up its market relations with the EU could potentially also still appear on the agenda should the Union negotiate an agreement with Japan. And it would be a mistake to think that there is little left to do within the countries of the north: whilst this is certainly true of trade tariffs, it does not hold for services or regulatory barriers.

Services markets still offer great potential

In the medium term the greatest untapped potential lies in opening up services markets, above all those in transport, business-related services and telecommunications. In all these areas serious barriers

[5] Deutsch (2011) with references, WTO (2011).

to market access still exist in respect of trade, investment, the provision of services locally and labour mobility, partly within North America and the EU (e.g. air, rail and bus transport, shipping, public procurement and the liberal professions), but chiefly outside those regions. In none of the trade negotiation formats pursued so far has a practicable approach been found for bilateral market liberalisation.

Free trade agreements could also provide impetus

At the moment it is still an open question whether talks on services in the World Trade Organization can be continued with any prospect of success. Little headway has been made so far with the bilateral and plurilateral formats. The same applies to such high-level regulatory dialogues as the Transatlantic Economic Council, regulatory dialogues between the EU and Japan and China, and bilateral US activities with China. Bergsten rightly laments this state of affairs inasmuch as it is extremely significant for the generation of export revenues by the United States, as the world's major exporter of services.[6] Even if the Doha Round is not brought to a conclusion, the big industrial nations should additionally consider whether it might not be advisable to pursue further sectoral and plurilateral paths to market opening in important services sectors within the framework of the WTO, or indeed outside it.

Direct investment: Indirect obstacles substantial in some countries

Recovery in direct investment still underway

In addition to world trade, real production networks also have an important part to play in reviving the forces driving international growth. The reciprocal development of sales markets in large industrial and emerging nations in technologically sophisticated sectors depends on more or less open, competition-based rules.

Market-opening regulations still predominant

By the end of 2010 foreign direct investment had not yet recovered fully from the crisis. At USD 1.24 tr, global inflows were still 15% short of their pre-crisis average. By 2013 the volumes are expected to have risen to their 2007 peak level. Already, half of this is being channelled into emerging markets. Another USD 2 tr takes the form of other types of international production (outsourcing, franchising, licensing and management contracts). 11% of the investment volumes are controlled by state enterprises.

Although global investment policy is still hallmarked by a multitude of market-opening measures and agreements, since the crisis restrictions have nevertheless gained in emphasis. Agriculture and raw materials are the sectors most affected by increasing barriers.[7]

The greatest barriers to direct investment still exist in the emerging markets, and there in particular Asia. These countries continue to drag their feet on market liberalisation. But in some industrialised countries, too, a more liberal attitude towards direct investment remains an important factor for economic revival. Some countries still possess extensive industrial holdings and assets (real estate, marketable infrastructure) in public ownership, in some cases with the deliberate intention of not permitting direct investment from abroad. Whilst Russia is the chief culprit, countries such as France, Greece, Portugal and others also exhibit a considerable measure of direct state involvement in economic activity. Japan is repeatedly admonished to dismantle technical barriers to trade and investment.[8] Recently some countries have also introduced security checks or applied existing controls restrictively. And political

[6] Bergsten (2011).
[7] UNCTAD (2011), WTO, OECD, UNCTAD (2011).
[8] OECD (2011).

sensitivities persist with regard to commitments by sovereign wealth funds.[9]

G20 work programme could send out signal

The G20 could push for a work programme to scale down crisis-related interventions and generally open up markets to foreign direct investment, and in this context they could encourage the really big emerging markets in the G20 group to join the vanguard of such a movement. It would be greatly to those countries' advantage, as well as to suppliers from the industrial nations. Even if the short-term outlook for a stronger set of multilateral rules on foreign direct investment within the framework of the WTO or OECD is not rosy, something can at least be done towards market opening.

International climate policy posed for breakthrough

Still no climate policy framework

In international climate policy, too, the Copenhagen and Cancún summits have set the scene for the global pricing and capping of greenhouse gas emissions only in very rudimentary form and with very low levels of commitment.[10] It is obvious that the industrialised countries' transformation into low-carbon economies over the course of several decades should ideally thrive in a clear political and legal environment in which the necessary investment can be made in the energy industry, the transport sector and housing construction.

The pattern so far, with a broadly developed climate strategy by the EU and a patchwork of sectoral policies in the US, falls far short of what is possible. However, the emerging signs of a U-turn in Japan's energy policy do hold out opportunities.

Global carbon market still remote prospect

Given the blockade on reform in US climate and energy policy, the establishment of a nationwide emissions trading system in all the heavyweight industrial countries and their subsequent linkage is highly unlikely for the time being. A genuine global emissions market is therefore still a very remote prospect. Moreover, the alternative environmentally fair way of pricing greenhouse gas emissions by means of Pigouvian taxes on their negative externality is not on the US political agenda. Fuel tax revenues are declining in real terms and are much too low. The regional emissions trading systems cover only fractions of the emissions. Fossil energy production is subsidised, and the generation of renewable energies is still very low.

EU leads on emissions trading

So far, only the EU is on track to achieve substantial revenues from emission rights trading during the third European Union Emissions Trading System (EU ETS) period beginning in 2013. Europe also imposes the highest rates of taxation on energy consumption. What is more, the Member States have committed to reduction targets outside the ETS as well, to enable them to meet the targeted 20% reduction in emissions by 2020 in comparison to 1990. Yet high explicit or implicit subsidies can still be found for fossil energy sources and nuclear power which, to put it diplomatically, can be described as having 'evolved historically', but by no means systematically reflect the full social and environmental costs.

European dimension

In terms of European integration, too, Community policy is far from having emphatically pursued all routes that might potentially lead to strengthening the forces of growth. At its June meeting the

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[9] See Kern (2009) on this subject

[10] See Koch-Weser (2010) on Cancún.

"Europe 2020"* strategy targets

Targets EU 2020	EU core targets	Estimate for the EU
Employment rate, %	75%	73.70 - 74%
R&D in % of GDP	3%	2.65 - 2.72%
GHG reduction**	-20%	-20%
Renewable energies	20%	20%
Energy efficiency***	20% increase (368 Mtoe)	206.9 Mtoe
Share of early school leavers, %	10%	10.30 - 10.50%
Tertiary graduates, %	40%	37.50 - 38.0%
Exclusion****	20 m	n.a.

* According to the targets set in April 2011 in the Member States' National Reform Programmes (NRP)
** Reduction of CO_2 emissions in the non-ETS sector
*** Reduction of energy consumption in Mtoe
****Lowering the share of the population at risk of poverty or social exclusion, number of persons

Source: European Commission 6

European Council stressed that the commitments to reform the labour market and in respect of energy efficiency and research and development were lagging behind what had been pledged. Although the Europe 2020 strategy[11] has already mapped out some main points, various of which have been specifically reemphasised with the Euro-Plus Pact, even those familiar with the topic have difficulty in following exactly how the interplay between national reform programmes and EU-wide measures works.

But Community policies need to put down certain important markers in order better to mobilise the supply of labour in the EU, to increase labour productivity and to stimulate investment in the medium term. The Commission is quite right in its assessment that the only way of avoiding a "lost decade" is by not focusing exclusively in 2011/2012 on budget consolidation and European management of the debt crisis; at the same time it is important to chart the course towards growth in both national and EU policies.

Strengthening internal market is the ideal way

Improve business environment

Amid growing tensions in what has, since 2005, become a significantly more heterogeneous internal market, development and realisation of the single European market should be prioritised in areas of importance to future economic performance.[12] Still-considerable potential remains to be leveraged in the fields of public procurement, armaments and the energy industry. The same is true of the Services Directive, which – although it will be implemented shortly – needs to be reviewed in terms of its impact and scope. Strengthening the business environment with improved regulatory conditions for start-ups, as one example, administrative costs in general, patent issues (the EU-wide Community patent!) and the tax framework (the Common Consolidated Corporate Tax Base - CCCTB!) have still not been adopted by the Member States. Similarly, outside the United Kingdom little has changed over the last decade in the egregious lack of venture capital, although the Commission also believes that this would unleash enormous impetus for start-up companies and innovation financing. Work similarly remains to be done on increasing labour mobility within the single market, which is still seriously hamstrung by complex tax and social legislation. But at least the mobility of workers within Europe is already acting as a welcome buffer to stabilise the standard of living in some crisis-ridden economies.[13]

European Financial Framework 2014-20*

Title	Proportion 07 - 13	Proportion 14 - 20
Smart and inclusive growth	40.03%	47.89%
Sustainable growth	43.05%	37.36%
Security and Union citizenship	1.19%	1.81%
Global Europe	5.8%	6.83%
Administration	5.83%	6.11%
Compensation	0.09%	-
Total	100%	100%
Total in EUR bn	862	1025

*Commission proposal

Source: European Commission 7

Wherever possible, the EU budget's focus on stimulating growth should be reinforced.[14] The negotiations on the European Financial Framework 2014-2020 provide a window of opportunity for this, the best chances resting with the two major spending categories sustainable growth and natural resources, for which the Commission has proposed appropriating roughly 85% of spending in the next multiannual budget period. The share of the budget dedicated to agricultural subsidies would shrink and expenditure on sustainable growth be increased. In general, spending is to be geared more closely to the EU 2020 strategy, which would be of particular relevance to R&D expenditures, structural policy, greater European cohesion through completion of missing transport and power links, and measures to increase employment. It is, however, regrettable

[11] European Commission (2010, 2011).
[12] Monti (2010).
[13] See Bräuninger and Majowski (2011).
[14] See Heinen (2011) for discussion on this issue and the European Commission (2011b) on the proposals for the next period 2014-2020.

that infrastructural and employment measures could not already be undertaken in the current period precisely in those countries which most need such stimulus, with Greece as a case in point. This is due partly to the fact that the necessary administrative conditions were not in place and to financial constraints in co-financing. In general, however, the Council's instructions to the Commission to redirect the EU funds available towards measures designed to promote growth and employment should be followed and implemented without delay.

Gear EU 2020 to growth

The EU 2020 strategy can likewise be examined for its potential in this area. From among the seven "flagship initiatives" of the EU 2020 strategy special attention must be paid to creating an Innovation Union and coordinating R&D policies, to a single market in energy and digital services in particular, to the legal framework for the ICT sector and to horizontal measures to improve the business environment (simplifying bureaucracy for SMEs, facilitating market access for businesses). And to provide further impetus, the reins should be tightened again on state aid policy and on opening procurement markets.

National structural reforms

Activate labour

In spite of what many observers may think, the industrialised nations are not starting out from scratch in respect of structural reforms to speed up the pace of growth. It is, however, true to say that the measures taken have been slanted more towards boosting productivity than to activating labour input in the respective economies[15]; with the major shortcomings still identified in legislation on protection against dismissal, wage setting processes, passive wage replacement benefits in case of unemployment, housing and healthcare. In the OECD's assessment most countries still have very long to-do lists here.

Consolidation difficult everywhere

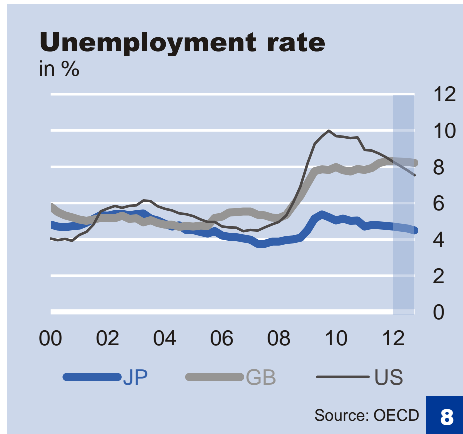
The demands made by consolidation alone are certainly no mean task. Scenario calculations[16] have revealed that the United States, the United Kingdom, Spain and the three euro members on IMF programmes still have a particularly long way to go on budget consolidation to take them from a primary deficit in 2011 to the sustained primary surpluses needed; gaps ranging from five to 15% of GDP pose enormous challenges for national fiscal and economic policy. There is no room for complacency in Germany, France, Italy and Japan either, all the more so the higher the benchmark is set (stabilisation of the debt ratio at the present level, return to the pre-crisis level or even achievement of the debt levels of 60% and below that are considered safe).

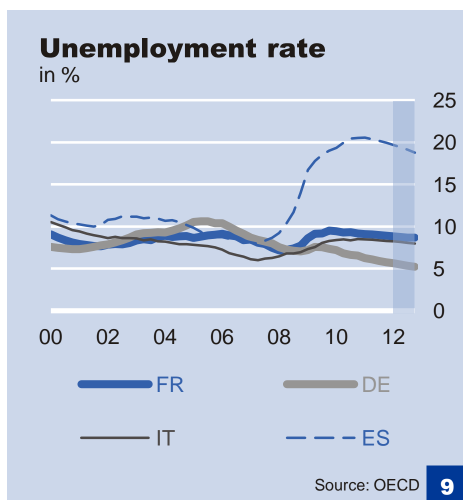
Dangers to growth apparent

Whilst such long-range consolidation processes need not necessarily be accompanied by declining potential growth, the danger does nevertheless exist. Whether positive confidence effects can outweigh short-term Keynesian effects depends very much, however, on national profiles. The key factor is medium-range growth expectations during a consolidation episode, which in turn depend on a country's entire economic and fiscal policy and its wage setting behaviour.

[15] The OECD identifies progress chiefly in the promotion of innovation, on efficiency gains in the public sector, on relief in the taxation of labour, active labour market policy and pension systems reform, see OECD (2010), pp. 73-75.

[16] Becker and von Rotberg (2011).





To make matters worse, the crisis itself has additionally weakened potential. At the very least, unemployment in the large majority of countries will presumably remain above its 2007 pre-crisis level for many years, and this will curb growth. Negative migration balances in individual countries such as Spain or Ireland may have a further depressing effect. The higher cost of capital is another probable weakening force. And it remains to be seen whether latter-year increases in investment on education and innovation, for example, can be maintained, let alone stepped up, in the coming, considerably tougher years.

Added to this are the repercussions on potential growth of all the new regulations imposed on the banking and financial sector. It is to be feared that the far more stringent capital and liquidity requirements and the whole host of other regulatory elements (levies, taxation of financial transactions, standardisation of derivatives products etc.) will, in total and in the medium term at least, further fuel de-leveraging in the financial system, making borrowing considerably more difficult for the real economy (businesses and households) and for governments. That could cost the industrialised countries a good half a point annual real GDP growth over a period of several years – a dimension potentially on roughly the same scale as the cumulative effect of well implemented, comprehensive structural reforms.[17]

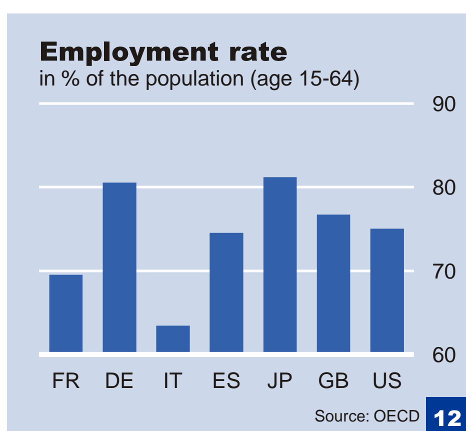
The OECD is certainly right in its assessment that, with unemployment running at high levels in most northern countries, the focus should initially be placed on what will impact on employment in the short term. This should then gradually be enhanced by measures with a long-range horizon.

Labour market policy in times of crisis

Priority should be given to labour market policy measures chiefly in those countries that are running high unemployment. In southern Europe, reforms of collective wage setting conducive to employment, strengthening of “outsiders’” rights through amendments to dismissal and recruitment regulations and targeted active labour market measures for youth and elderly people should be to the fore. In the medium term these countries could also benefit from organising work more flexibly with a time credit system of individual working time accounts, company-level or collective overtime rules or arrangements on part-time work like those in, say, Germany. Greater use of temporary employment could also be considered. This works particularly well where the social partners venture into a dialogue on pragmatic solutions and jointly advertise its successes. Supplementary social security measures for more flexible employment relationships of this kind could act as helpful backstops, with Denmark as an instructive example. Otherwise the three countries that have already succumbed to the euro crisis, together with Spain, face the threat of permanently high unemployment and the massive macroeconomic and fiscal costs this implies. Italy, Spain, Belgium and France likewise need more flexible wage setting mechanisms to pave the way for settlements geared to creating jobs.

Generally speaking, Italy, Belgium, Greece and France, for example, still have quite some scope to increase employment rates. Italy is

[17] A heated debate has since erupted over this issue. See, for example, IIF (2011), FSB/BCBS (2010) and McKinsey (2011) on the relevant positions. Essentially, differences revolve around the question of whether the capital markets enable financial institutions to obtain low-cost equity and debt financing or not.



almost 20 percentage points below the Danish level and France still ten points. It is not an impossible undertaking: in the pre-crisis years Spain, Germany, Austria, all the Scandinavian countries, Japan, Australia and New Zealand made considerable headway. Gradual relief in the taxation of labour would be helpful; similarly, specific training and further education programmes to support and encourage the employment of young people and other at-risk groups are warranted in a number of countries; improvements in job placement efficiency are also to be recommended. And in some countries the unemployment insurance parameters should be adapted to circumstances. Where eligibility criteria and benefits were initially broadened, now gradually attention must refocus on the incentive effects.

In America, too, support and promotion measures will presumably still be needed for some time to come in order to help prevent labour markets from becoming encrusted by a permanent rise in the number of long-term unemployed and to mitigate a trend deterioration in labour productivity following its strong, cyclically induced upsurge. This could certainly happen through a loss of skills if people capable of employment are out of work for too long. In view of the exceptionally steep rise in unemployment, weak passive and active security systems and the slight declines in what was essentially an above-average employment rate between 2005 and 2009, measures to stimulate the economy and shore up the jobs market in the US remain high on the agenda. These include tax privileges specifically for the low-skilled and unemployment benefit extension, which should not be revoked until the employment situation picks up again appreciably. Far greater effects still could result from a reorganisation of the US tax system reducing the effective tax burden on labour and placing the direct burden more squarely on real estate assets, pollution (greenhouse gas emissions) and energy consumption and introducing a national value added tax at a moderate rate.

Reform social security systems

Governments should also push ahead with structural reform in the various areas of social security. Although some steps have been taken in recent years, notably on rolling back the incentives in pension systems to take early retirement, on introducing actuarially adequate systems, raising the state retirement age and building up partially funded systems either to replace or supplement existing schemes, the large majority of countries have yet to implement sweeping cost-cutting and efficiency-enhancing reform of their healthcare systems. The OECD quotes the average potential savings at 2% of GDP, but in individual countries such as the US this figure has been shown to be considerably higher. At the same time, however, issues surrounding the reform of funding for collective social security systems have recently been put on the back burner again. Yet the effective marginal tax burden on low-skilled and medium-skilled workers resulting from the combined effect of the taxes and contributions levied on labour and the withdrawal of transfer payments do play an important part in getting people (back) into work. Fundamental reforms of the way these systems are funded, directed at reducing this burden and generating more of the revenues through alterations in the tax base (assets, pollution), have not yet been pursued far enough.

According to the European Commission, state expenditure on retirement pensions in the euro area could climb from 11% of GDP in 2008 to 13.8% by 2060. In most countries, the critical phase during which demographic pressures are at their most severe will occur between 2025 and 2040. But Greece and Spain in particular can expect problems even in the current decade.

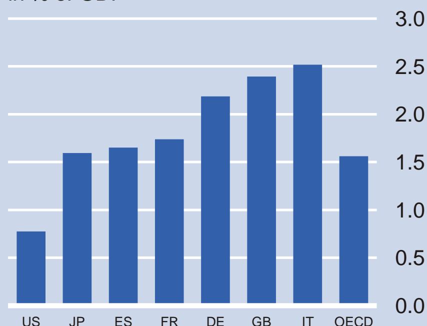
Recently, however, various countries have set substantial pension reforms in motion – Greece and Spain among them. Instead of the expected doubling in the ratio of state spending on retirement pensions to roughly 24% or 15% of GDP in 2060, the rise in government transfers could turn out to be less – providing, of course, that the reforms passed are implemented consistently.

Indeed, by raising the actual retirement age in the euro area by 1.5 years up to 2030 and thereafter by another six months up to 2050 the economic dependency ratio (people receiving benefits in relation to people in employment) could be broadly stabilised.

Source: Bräuninger (2011)

Eco tax revenues

in % of GDP



Source: OECD

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Move forward on green growth

For all the political emphasis placed on "green growth", particularly when economic stimulus packages were being put together from America to China in 2009 to combat recession, major conceptual and political shortcomings still exist in development of the consistent strategy needed to achieve the industrial nations' self-imposed emission reduction targets of around 80% by 2050 (on the basis of 1990). There is a whole host of official and unofficial transformation studies and scenarios with abstract descriptions and calculations of how to achieve this.[18] Essentially they revolve around getting markets to change course by putting a price tag on negative environmental impacts through taxation or emissions trading systems. These are typically supplemented by guidelines for the promotion of technologies, mainly renewable energies, and an aspirational programme to increase the energy efficiency of products, motor vehicles and buildings. Both state investment in infrastructure and suitable regulation play an important part in many technology areas, as for example in the development of a modern electric grid infrastructure or carbon capture and storage.

Moreover, whilst new investment volumes – and hence stimuli to value creation – can be estimated, faster-diminishing values of capital stock made obsolete by climate policies are hardly factored into considerations and calculations at all. It is likewise difficult to assess the possible value creation and employment potential resulting from the development of new energy and transport systems, from climate-friendly changes in construction methods and in existing building retrofits, from increased efficiency in industrial production and greener agriculture. In this regard science offers too few rather than too many indications of where national green growth strategies might best begin, even if broad academic consensus does exist meanwhile on the toolkit to be used for the purpose. Nevertheless, there is sufficient reason to assume that the redirection of investment behaviour along these lines and appropriate changes in consumption should give rise to positive growth and employment effects, at least in the medium term – especially if the higher environmental taxes are used to reduce the taxation of labour.[19] The positive impacts also apply in particular to low-emission types of energy generation and distribution.

In the EU, too, national and Community-wide efforts are not yet sufficiently underpinned by clear-cut blueprints. This is true, among other aspects, of coordination between long-range emission reduction requirements – within the framework of emissions trading and beyond – and actual investment patterns in the energy sector, of the coordination of at least part-public infrastructure investment in energy networks, and of the integration of climate-friendly transport infrastructure, urban planning and housing policies at national and partly also Community level. And the field of efficiency improvement still lies largely fallow. Some observers also assign an important role to the development of intelligent EU-wide electricity networks together with improved regulation of the EU electricity market. But for all these shortcomings, the EU has already set the stage for greening the growth path. However, the process could, and should,

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[18] The Stern report (Stern 2006), European Climate Foundation (2011), IPCC (2011), McKinsey (2009), OECD (2011b, c), UNEP (2011) and WBGU (2011) are just some examples.

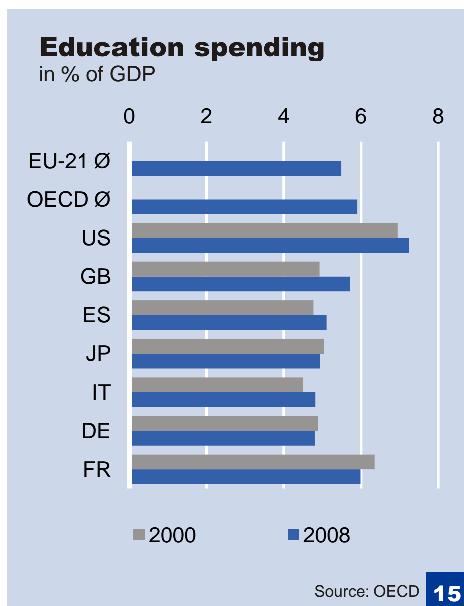
[19] OECD (2011b) with a discussion on the modelling projects and their preliminary results.

be speeded up by more consistent application of the instruments in the toolbox.

Open up product markets

Market opening helpful

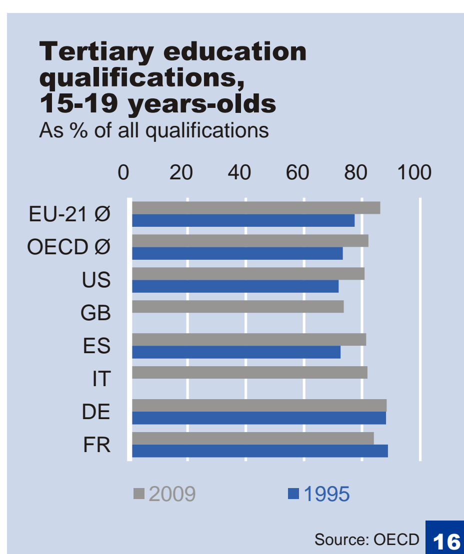
Besides direct labour market policies, rapid effects can be achieved mainly by relieving companies of some of their bureaucratic burdens and dismantling barriers to market access for businesses in the course of product market reform. Japan, for example, should address the obstacles to market entry and exit for companies. In turn, many countries in mainland Europe should direct their attention to improving the environment for start-ups and to administrative procedures and the provision of venture capital.



Invest in education

An additional focus should be placed on driving forward structural reform in education systems. Changes in human capital resources can, over longish periods of time, make an important contribution to growth.[20] Admittedly, this is just a trend observation, given that countries – especially those in the grip of crisis – can at present hardly manage to find enough jobs for highly skilled young people. As a result of this development, internal migration within Europe could increase significantly.[21] That may at least temporarily help relieve adjustment pressures and reduce unemployment in the countries in crisis.

In general, notwithstanding the reforms already instituted, the major industrialised nations still have a great deal of work to do, not least on education. The rules governing access to education systems, student mobility between educational institutions, the autonomy of educational facilities, the efficient use of funds and the provision of infrastructure in the pre-school and primary education segment are still below par almost everywhere, On average, Europe lags behind the US and Japan on important indicators in particular. Total public and private expenditure on tertiary education in the EU stands at just over 1% of GDP, well below the 1.5% registered in Japan and nearly 3% in the US, even though public spending is higher than in Japan. And only 30% of 25-34 year-olds have tertiary education qualifications, compared with 40% in the US and more than 50% in Japan. Fifteen year-old Europeans' average literacy skills fall far short of other OECD countries.[22]

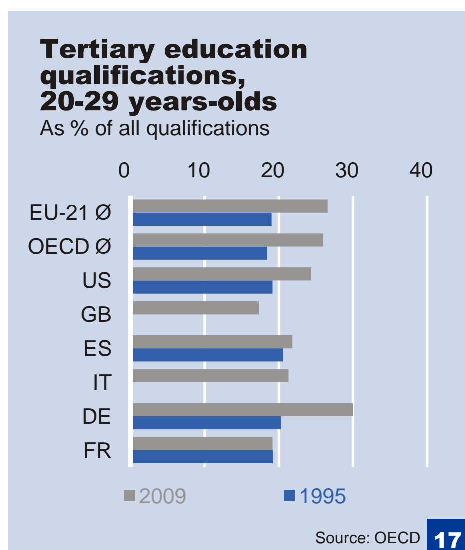


What is more, education funding so far is driven only very occasionally by considerations of the private benefits that accrue from tuition. Specifically, this implies the need to introduce student fees and grant systems as one way of addressing the still pressing issue of underfunding in higher education. The EU has at least made some headway on increasing education spending as a whole and on plugging the glaring gaps arising in different national arenas; but the OECD attests failures to meet targets in practically all countries.

Political economy of growth

It might seem logical that fostering growth would be a win-win game for governments on the domestic political front as well, since growth can work to the advantage of both employees and businesses. Yet

[20] Bergheim et al. (2005), Bergheim (2006).
[21] Bräuninger and Majowski (2011).
[22] All particulars according to the Commission (2010b).



experience with major economic crises in the past has taught us that internal political dispute over macroeconomic adjustment strategies and structural reforms to accommodate new global economic scenarios can differ considerably between countries, as these in turn exhibit quite different political constellations.

This was precisely the case with reactions to the Great Depression in the industrialised world during the 1930s, and it was also evident in the response to the oil crisis of 1973/74.[23] Although social changes have taken place since then, the political economy of reform will still not lead to parallel growth and consolidation coalitions in all large industrial nations. On the contrary, national strategies have in the past been shaped quite considerably by the traditions and structures of the state, by the power of interest groups, by economic policies, ideas and ideologies and by party-political conflict. And that is presumably what will happen again in the present crisis.

The political reaction to the financial and economic crisis that we have seen so far from governments in Asia, Europe and America shows that, aside from similarities in the Keynesian response, what is now emerging most starkly are the differences in how countries are coping with the credit crunch amid dramatically different debt situations, and differences in the accompanying growth policies they are framing.

Political conflict over the direction of monetary policy has intensified appreciably over the last two years, both in Europe and America. But at least there are signs that fiscal consolidation is becoming standard procedure everywhere. Surprisingly few fundamental differences of opinion are surfacing in Europe over the course that fiscal policy should steer, whereas in the United States the tortuous process of compromise between fiercely rival Democrat and Republican camps has only just begun. The recent decisions there are arguably the very least that is needed to stabilise the debt ratio in the coming years, and even then at a very high level. In the United Kingdom it remains to be seen whether the extremely restrictive multi-year programme can be sustained.

To begin with, however, the profound crisis has set in motion a parallel course of structural reform. A package of structural reform has been agreed with the countries in crisis as part of programme conditionality, and other countries too have launched measures of this kind, Spain being the most prominent among the big economies in mainland Europe. But then again, hardly any consistent approaches on growth policy are to be found in the United States, the United Kingdom and Japan.[24]

The G20 countries therefore still have a very long road ahead of them in terms of coordinated growth policy. It will be quite a few years until we see whether the combined national dosages of consolidation exerting a restrictive impact – at least in the short term – and structural reforms will make a steeper potential growth trajectory possible or not.[25] EU-wide and international reform efforts could certainly be helpful in this context.

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[23] Among the classics are Gourevitch (1986) and Katzenstein (1978).
[24] On the political growth agenda see the paper in Deutsch (2010), Bergsten (2011) and the OECD country reports.
[25] On the controversy between Alesina and the IMF see Alesina (2011) and IMF (2011).

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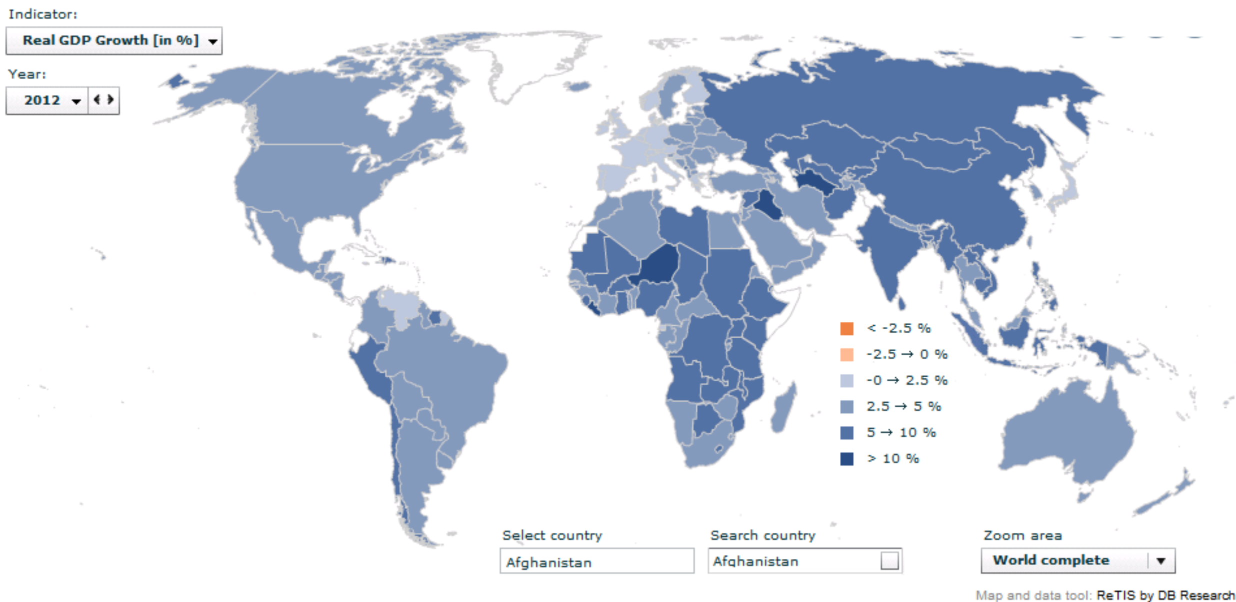

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