



A 2020 Strategy

This contribution has been elaborated in the frame of the collaboration

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The European economy was hit by the worst crisis in the European Union's history. There is therefore a major need to increase the European growth potential in the medium and long run in order for Europe to regain momentum in growth. All in all there is a huge difference between letting things be and doing something active to get the European economy back on track. The structural changes in the European economy will break the unemployment curve and increase employment so that employment will be above its 2008 level already in 2014, compared to the passive scenario where employment not will be above 2008 level until 2019.

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Main conclusions:

- The European economy was hit by the worst crisis in the European Union's history. There is therefore a major need to increase the European growth potential in the medium and long run in order for Europe to regain momentum in growth.
- The strategy suggested in this paper (the 2020 strategy) shows an alternative way for the European economy. The strategy is based on the underlying ideas in the PES paper "A progressive Strategy for a Green, Smart and Inclusive Europe". The strategy outlined in this paper is focusing on the following three pillars: A smart green growth strategy, a higher productivity and education level and fighting social inequality.
- All in all there is a huge difference between letting things be and doing something active to get the European economy back on track. If the strategy is implemented, growth rates will on average be at above 2 percent in the coming ten years. The structural changes in the European economy will break the unemployment curve and unemployment will fall from 2011 till 2020 where unemployment will be 5½ million lower than without the structural strategy. With the structural changes it is possible to increase employment so that employment will be above its 2008 level already in 2014, compared to the passive scenario where employment not will be above 2008 level until 2019.



The European economy was hit by the worst crisis in the European Union's history. Even though GDP seems to be growing again the labour market is expected to be hit hard in the years to come, and we cannot prevent that unemployment will rise to around 10 percent this year and stay on this level for several years.

There is therefore a major need to increase the European growth potential in the medium and long run in order for Europe to regain momentum in growth. Changes in business cycles in the short run can be responded to with financial stimulus. In the medium and long run, an economic upturn requires structural changes in the form of reforms that changes the underlining structures in society in a wide range of areas.

In the light of the crisis most European countries have stimulated the economies. That, combined with increasing expenses to unemployment benefits and lower tax revenues, has resulted in deficits that exceed 3 percent of GDP in most European countries.

Tightening fiscal policy might improve the budgets in the short run, but it does not change the fact that many Europeans are unemployed and if the fiscal tightening creates lack of confidence in the economy for consumers and investors, then the upturn may very well be jeopardized. In the medium and long run, an economic upturn in Europe requires structural changes in the form of reforms that changes the underlining structures in society in a wide range of areas, so that Europe quickly returns to its historical growth pad as well as increases the growth potential in the medium and long run. Such a development will create jobs, lower unemployment from its present historically high level and improve the budget.

Table 1 shows the key figures in the forecast for the next ten years.

| Table 1. Key figures in the present forecast | | | | | | | | | | | | |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| GDP (growth in pct.) | -4.0 | 1.1 | 1.9 | 1.5 | 1.7 | 1.8 | 1.8 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| Employment (million people) | 222.3 | 219.2 | 219.0 | 219.8 | 220.7 | 221.5 | 222.4 | 223.4 | 224.3 | 225.3 | 226.2 | 227.2 |
| Unemployment (million people) | 21.4 | 24.4 | 24.8 | 24.7 | 24.5 | 24.3 | 24.1 | 23.8 | 23.6 | 23.3 | 23.1 | 22.8 |
| Unemploy. rate (pct./labour force) | 8.8 | 10.0 | 10.2 | 10.1 | 10.0 | 9.9 | 9.8 | 9.6 | 9.5 | 9.4 | 9.2 | 9.1 |
| Public budget (pct. of GDP) | -5.2 | -5.5 | -5.0 | -4.7 | -4.7 | -4.5 | -4.4 | -4.3 | -4.1 | -4.0 | -3.8 | -3.7 |

Note: 2010-2020 are forecasted. Source: AE on the basis of OECDs Economic Outlook 86 November 2009 and Consensus forecasters October 2009, calculated with the international macroeconomic model HEIMDAL.

As shown above GDP is expected to grow again this year and then slowly return to its historical growth rate. Employment will start growing in 2012, but the increases will be moderate and not until 2019 will employment be back at its 2008 level. Likewise for unemployment - The unemployment rate will peak a little over 10 percent of the labour force, but will only slowly decrease.

The strategy suggested in this paper (the 2020 strategy) shows an alternative way for the European economy. The strategy is based on the underlying ideas in the PES paper “A progressive Strategy for a Green, Smart and Inclusive Europe”. The following elements are included in the strategy. Firstly, focus is on making a shift to low carbon activities by *implementing a smart green growth strategy*. Secondly, focus is on turning knowledge and creativity into the main resource of people, companies and regions by *implementing an ambiguous education strategy*. Thirdly, the focus is on renewing and strengthening the welfare system to fight social inequality. This could be done by creating *larger equality between men and women*, and by *increasing the education level for the weakest* and in this way lifting the incomes in the bottom. The strategy outlined in this paper is so to say focusing on the following three pillars:

1. A smart green growth strategy

By implementing a simultaneous investment strategy across the European Union we can obtain higher economic growth, productivity and prosperity. This could be investments in infrastructure such as road and public transportation, or environmental investments and energy renovations. But also investments in a greener energy system such as investments in wind mills etc.

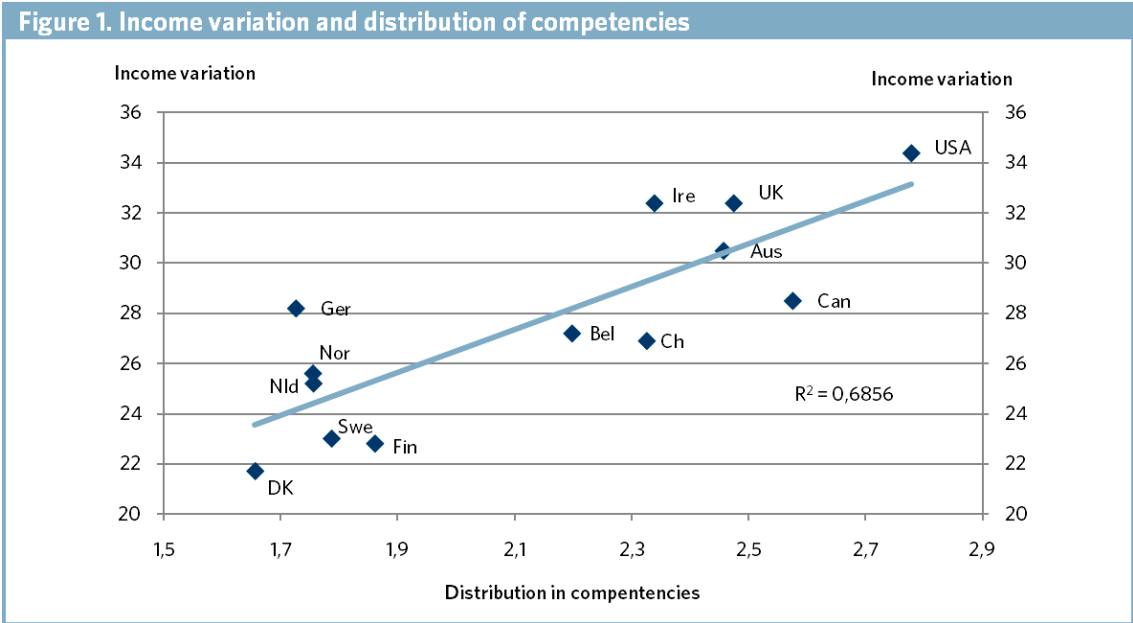
2. Higher productivity and education level

By increasing the education level and making sure that the European labour force increase and hold the skills that are required by society, we do not only increase employment and cut unemployment we also improve productivity for greater future prosperity.

3. Fighting social inequality

By increasing the female participation we can increase employment and create more equal opportunities for men and women. One way to make it more likely for women to participate in the labour force is to develop and substitute the public childcare system. By increasing the education level for the weakest we can lift the incomes in the bottom and in this way reduce income spread and hereby inequality (see figure 1 below). This can be done through investments in better education for the weakest in society, and through active labour market policies and active social policies targeted at the weakest in society. In this way we can fight social inequality by getting weaker groups employed.

Figure 1 shows income spread and variation in competencies in a number of countries. It is seen that there is a clear positive correlation between the variation in skills and the variation in incomes. In other words the more equal the competencies are in society the more equal will the incomes in society be. By lifting the education level for the weakest we can thus decrease inequality in Europe.



Note: Distribution of competencies measured as the best 95 percent relative to the worst 5 percent. Source: AE on the basis of data from OECD.

A strategy as the one described above, with simultaneous investments, improvement of the productivity, increasing employment, creating a sustainable development and changing the structure of public spending can and must be done differently in different countries as the different challenges must be taken into account – as well as different public budget situations. This analysis does not give a plan in detail for each country. Instead it sketches the effects of different initiatives and gives a scenario on how the effect could be.

The final effect will depend on the nature and pace of the initiatives. The following calculations will build on the three pillars: green investments, education and fighting social inequality. The scenario illustrates the effects of structural changes in the European economy in the coming ten years. Box 1 gives a detailed description of the scenario.

Box 1. Details behind the calculations

The medium term scenario illustrates the structural effects of implementing the strategy described above over the coming ten years from 2010 till 2020.

The initiatives are calculated as increasing the labour force by ½ percent point to the year 2020. This effect could come as a combination of effects of education, childcare, active labour market policies and research and development. Increased productivity and competition result in a lower inflation rate than otherwise have been.

The investment initiatives are assumed to be distributed equally between private and public investments so that the total investment level in the EU on average is 9 percent higher in 2020 compared to a situation without the investment plan.

The utilization of the extra resources in the labour market is subject to the condition that an active economic policy is implemented to increase demand on labour. The demand generating equilibrium is equally distributed between private and public internal demand. The inflation rate is assumed to be 0.2 percent point lower each year than otherwise.

Table 2 shows the forecast for the next ten years if structural changes are implemented within green investments, higher productivity and education level and lower social inequality.

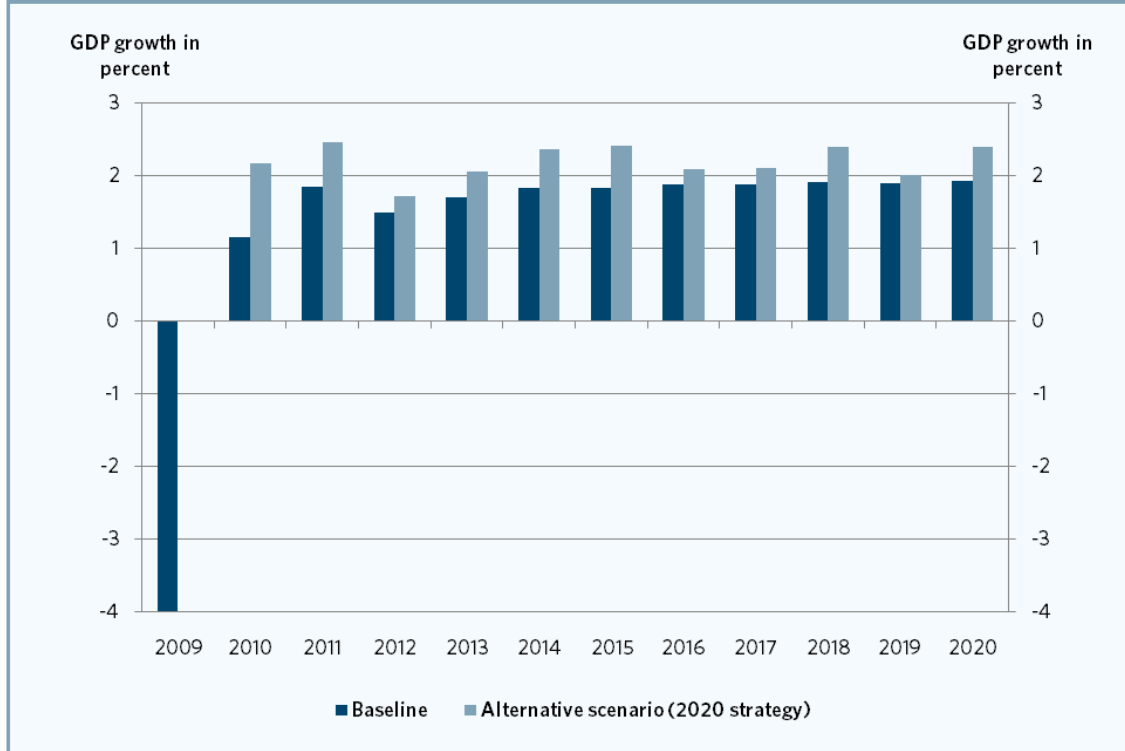
| Table 2. Key figures in the alternative scenario (2020 strategy) | | | | | | | | | | | | |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| GDP (growth in pct.) | -4.0 | 2.2 | 2.5 | 1.7 | 2.1 | 2.4 | 2.4 | 2.1 | 2.1 | 2.4 | 2.0 | 2.4 |
| Employment (million people) | 222.3 | 220.6 | 221.6 | 223.0 | 224.5 | 226.3 | 228.2 | 229.9 | 231.5 | 233.4 | 235.0 | 236.8 |
| Unemployment (million people) | 21.4 | 23.6 | 23.2 | 22.7 | 22.2 | 21.5 | 20.6 | 20.0 | 19.4 | 18.6 | 18.0 | 17.2 |
| Unemploy. rate (pct./labour force) | 8.8 | 9.7 | 9.5 | 9.2 | 9.0 | 8.7 | 8.3 | 8.0 | 7.7 | 7.4 | 7.1 | 6.8 |
| Public budget (pct. of GDP) | -5.2 | -5.3 | -4.8 | -4.5 | -4.5 | -4.2 | -3.8 | -3.6 | -3.4 | -3.1 | -2.9 | -2.9 |

Note: 2010-2020 are forecasted. Source: AE on the basis of OECDs Economic Outlook 86 November 2009 and Consensus forecasters October 2009, calculated with the international macroeconomic model HEIMDAL.

As shown in the table growth rates will on average be at above 2 percent in the coming ten years if the strategy is implemented. The structural changes in the European economy will break the unemployment curve and unemployment will fall from 2011 till 2020 where unemployment will be 5½ million lower than without the structural strategy. The structural changes will create a lot of jobs coming from, among other things, more women in the labour force, green investments as well as all the derived jobs coming from the increased demand in the economy. With the structural changes it is possible to increase employment so that employment will be above its 2008 level already in 2014, compared to the passive scenario where employment not will be above 2008 level until 2019. All in all there is a huge difference between letting things be and doing something active to get the European economy back on track. Figure 2-5 show the development in the key figures in the baseline scenario and the alternative scenario with the 2020 strategy.

Figure 2 (next page) shows how GDP will rise more in all years if the structural changes are implemented, than had been the case otherwise. In the coming years GDP will on average grow 0.4 percent more each year than without the strategy.

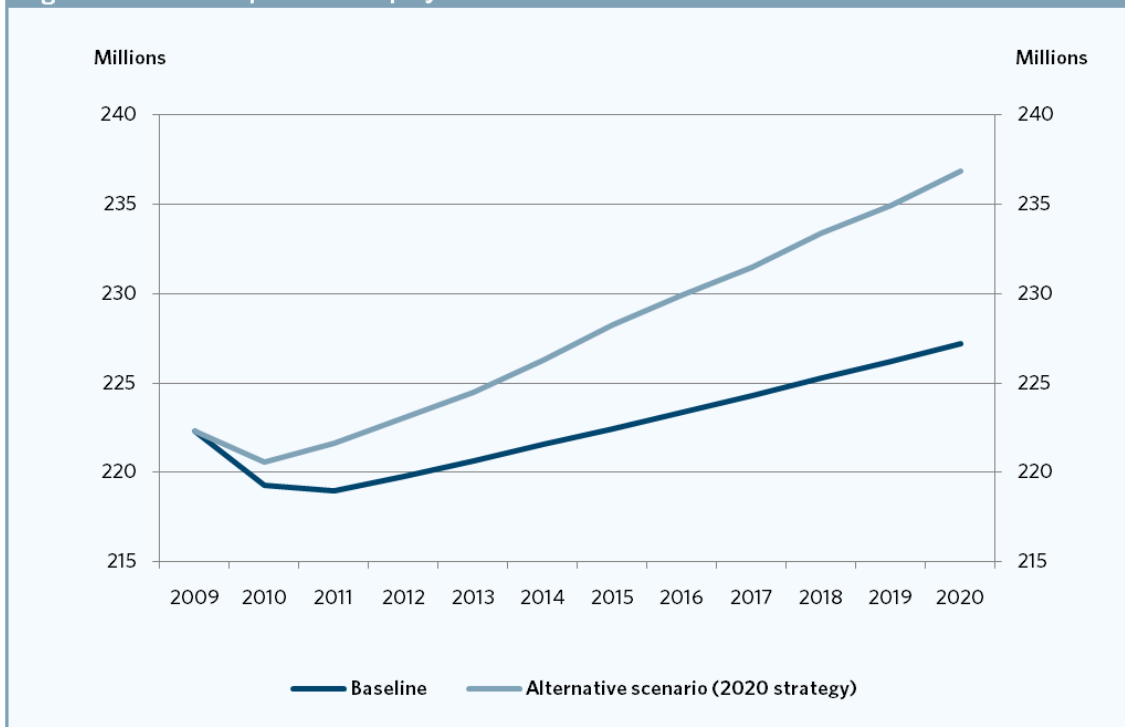
Figure 2. GDP growth in the two scenarios



Note: the structural changes are implemented in 2010-2020. Source: AE on the basis of the international macroeconomic model HEIMDAL.

Figure 3 shows how employment will be back at its 2008 level in 2014 if the structural changes are implemented. It also shows how the strategy all in all will create close to 10 million jobs over the next ten years.

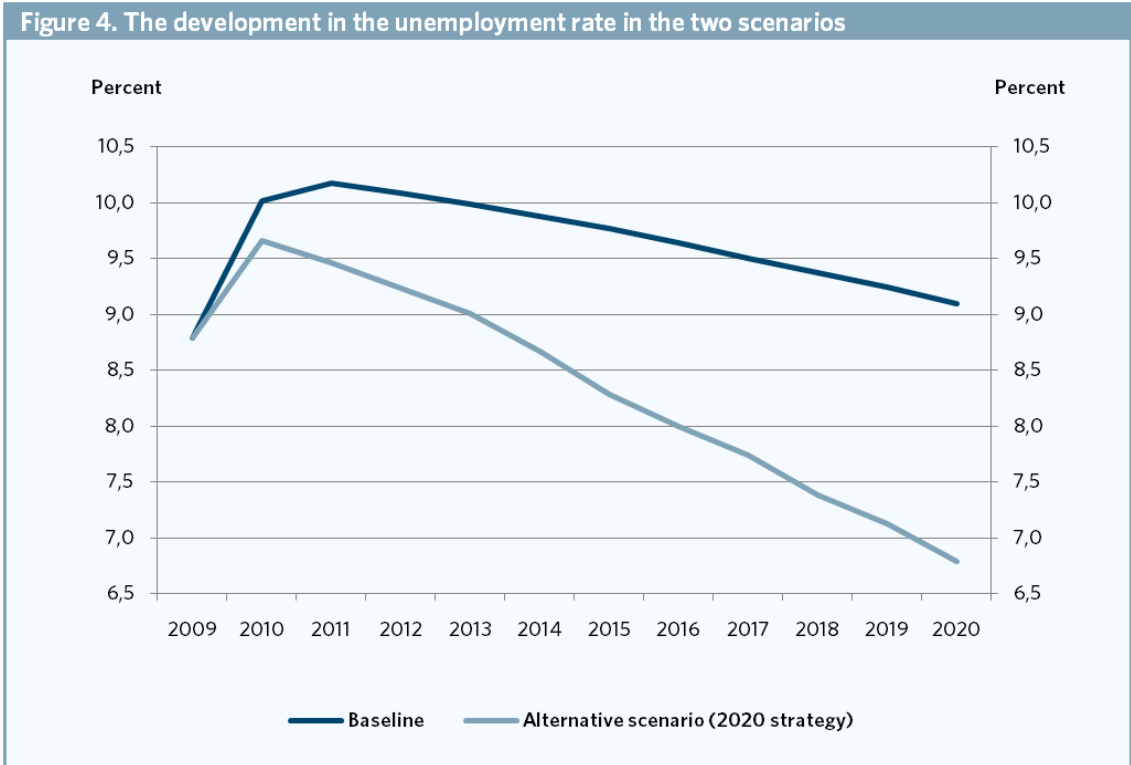
Figure 3. The development in employment in the two scenarios



Note: the structural changes are implemented in 2010-2020. Source: AE on the basis of the international macroeconomic model HEIMDAL.

As shown above huge improvements can be made on the labour market when implementing the structural changes and that even though e.g. increasing women’s participation rate also mean a higher unemployment in the short run until all the women have gained a foothold on the labour market. If active labour market policies are implemented, in order to help the women to get jobs and to be quickly integrated on the labour market, then unemployment can be expected to fall even more than assumed in the alternative scenario above.

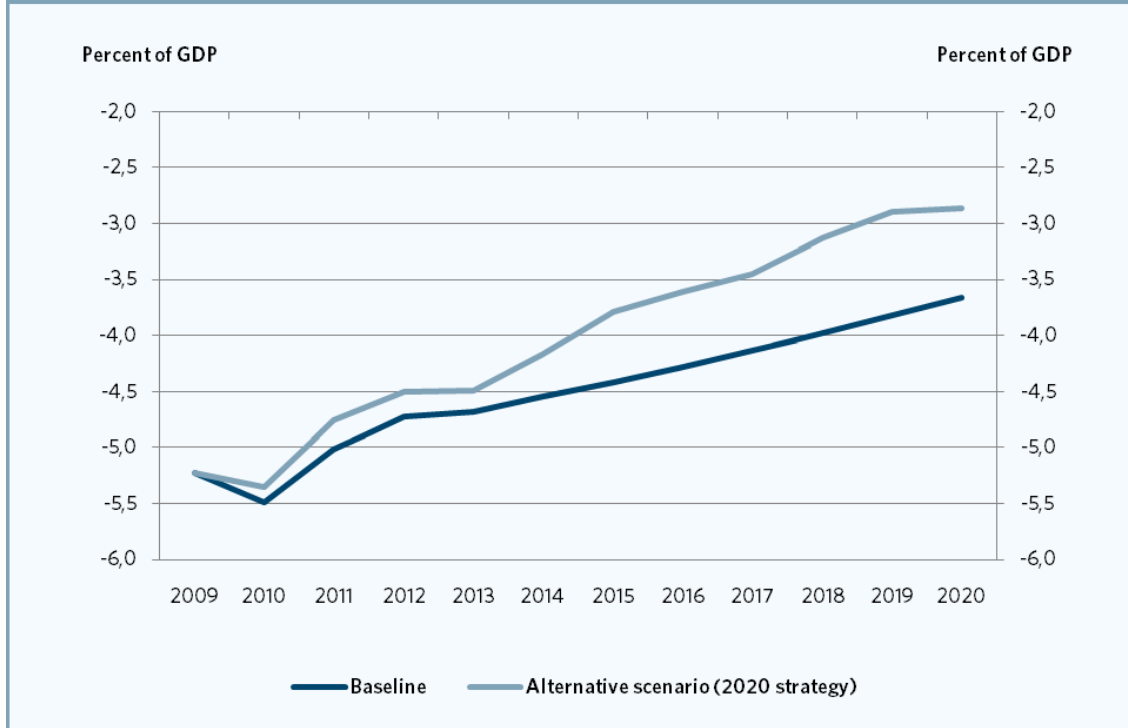
Figure 4 shows the development in the unemployment in the baseline scenario and in the alternative scenario. All in all the strategy can bring the unemployment rate down with more than 2 percentage points compared to a situation without the strategy. This corresponds to 5½ million fewer unemployed.



Note: the structural changes are implemented in 2010-2020. Source: AE on the basis of the international macroeconomic model HEIMDAL.

Figure 5 (next page) shows the development in the budget in the two scenarios. As seen the budget is improved as the unemployment rate falls. In 2019 the budget is expected to have improved to such an extend, that the 3 percent deficit ceiling is met.

Figure 5. The development in the budget (pct/GDP) in the two scenarios



Note: the structural changes are implemented in 2010-2020. Source: AE on the basis of the international macroeconomic model HEIMDAL.

Table 3 shows the effect on GDP and employment in a number of countries. In the period between 2010 and 2020 GDP will grow by nearly 5 percent more in the scenario with structural changes compared to the scenario where nothing is done. In employment terms the total effect on EU-27 will be more than 8 million extra employed in 2020 than would have been otherwise.

Table 6. Additional growth and employment, 2010-2014

| | Growth in GDP 2010-2020 (percent) | | | Growth in employment 2010-2020 (million) | | |
|----------------|-----------------------------------|--------------------------|---------------------------------------|--|--------------------------|-----------------------------|
| | Baseline Scenario (a) | Alternative Scenario (b) | Difference in percentage points (b-a) | Baseline Scenario (c) | Alternative Scenario (d) | Difference in million (d-c) |
| Germany | 15.9 | 20.5 | 4.6 | 1.0 | 2.2 | 1.2 |
| France | 21.3 | 24.6 | 3.3 | 1.4 | 1.9 | 0.5 |
| Italy | 13.9 | 19.4 | 5.5 | 0.5 | 1.2 | 0.7 |
| United Kingdom | 23.1 | 28.6 | 5.5 | 1.2 | 3.6 | 2.4 |
| Polen | 22.4 | 25.5 | 3.1 | 0.6 | 0.9 | 0.4 |
| EU-27 | 19.8 | 24.3 | 4.5 | 8.0 | 16.3 | 8.3 |

Note: the structural changes are implemented in 2010-2014. Source: AE on the basis of the international macroeconomic model HEIMDAL.

As shown in the figures above there is a great potential in implementing the strategy in the European countries. The strategy will draw Europe in the right direction, create jobs, cut unemployment and ensure that Europe will have a quicker return to its historical growth path. Some of the positive effects in this scenario are due to the fact that the European countries make a simultaneous effort regarding investments in childcare, education, R&D, social expenditure etc. This means that there are positive spill over effects on the individual country which enlarge the effects on employment and wealth and help the final effect on the public budget to be positive.

