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MCKINSEY GLOBAL INSTITUTE

AN OPPORTUNITY FOR EUROPE?

THE MCKINSEY GLOBAL INSTITUTE 2016 EUROPE ESSAY PRIZE

Key themes and winning entries

OCTOBER 2016

MCKINSEY GLOBAL INSTITUTE
ESSAY PRIZE

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MGI research combines the disciplines of economics and management, employing the analytical tools of economics with the insights of business leaders. Our "micro-to-macro" methodology examines microeconomic industry trends to better understand the broad macroeconomic forces affecting business strategy and public policy. MGI's in-depth reports have covered more than 20 countries and 30 industries. Current research focuses on six themes: productivity and growth, natural resources, labour markets, the evolution of global financial markets, the economic impact of technology and innovation, and urbanization. Recent reports have assessed the economic benefits of tackling gender inequality, the global consumers to watch, a new era of global competition, Chinese innovation, and digital globalization.

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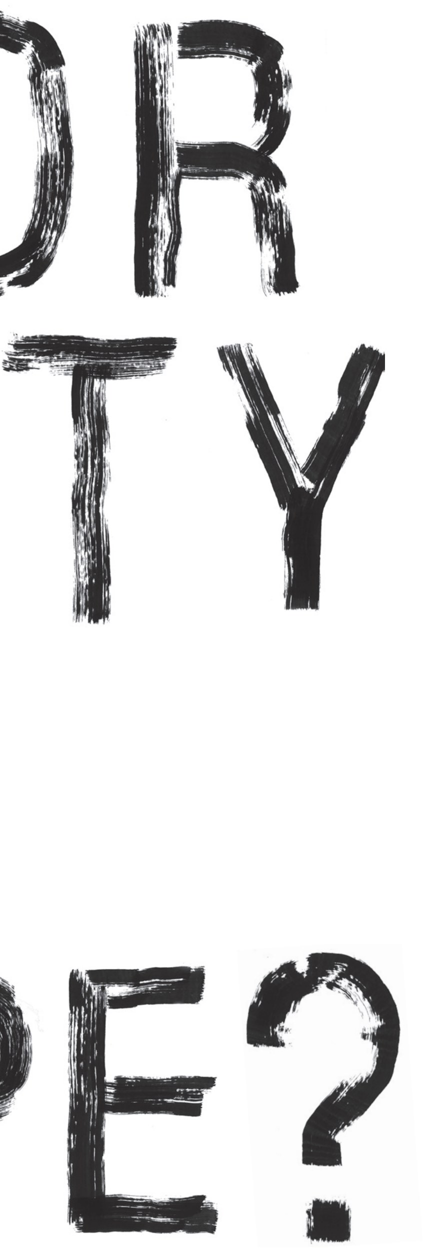

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PREFACE BY JYRKI KATAINEN, VICE PRESIDENT OF THE EUROPEAN COMMISSION

In a fast-changing world, Europe needs new ideas and new initiatives to achieve long-term sustainable growth that will make the continent more resilient, more competitive, and more innovative. At the European Commission, we have been working hard to complete the Single Market, build out a Capital Markets Union, and strengthen growth with our flagship plans for investment. We are not operating in a vacuum, however, and are always eager to hear new proposals and suggestions, especially from a broad public.

In that context, we have been pleased to support the McKinsey Global Institute's initiative to crowdsource ideas for growth-oriented reforms through its "Opportunity for Europe" essay contest. It is very encouraging for us to see that, at a time of some public scepticism about European institutions, there is still a tremendous amount of enthusiasm for the European project, and high expectations for policy reforms.

The number of submissions to the essay contest, the range of the ideas that were aired, and the breadth of participation from people around the globe, all are causes for hope and optimism. This shows that, even in complicated times, there are many creative people—and not only in Europe—with strong ideas about the future of our continent, and its unique form of political and economic integration. It is very timely and important that we debate a comprehensive strategy for the European Union, together and constructively.

I am particularly glad to note the large participation in this essay contest by authors under the age of 30. They are Europe's future, and it is vital that we connect with this generation—and that this generation in turn views Europe as relevant and important for its future. We would like to see increasing engagement around these ideas with young people across the continent in the coming months and years. What is striking in many of the essays by these young people is a refreshing realism that reflects Europe's great intellectual heritage, and a pragmatism that is in keeping with the construction of Europe over the past 60 years.

I would like to offer my heartfelt congratulations to all participants, and especially to the worthy winners. We strongly believe that collaboration and the sharing of ideas between institutions, countries, communities, and individuals over the coming years will become ever more important. This essay contest is a reminder of how positive and useful the results can be. We now look forward to engaging in a dialogue with the authors to see how the best ideas can be taken forward.

THE MGI ESSAY PRIZE: CONTEXT AND OBJECTIVES

Developments in Europe have been a recurrent focus for the McKinsey Global Institute since our founding in 1990, the year Germany unified. Europe has come a long way since then—further than many people realize. Europe generates 25 percent of global GDP and is home to a highly integrated domestic market. While European economies have faced numerous challenges, especially in the aftermath of the 2007–08 financial crisis, they remain global leaders on most of the dimensions that matter to citizens—from health care and safety to environmental protection. More European companies are listed in the Fortune Global 500 than US ones.

Despite these strong fundamentals, Europe is less dynamic and resilient than it could be. Growth overall remains sluggish, almost a decade after the onset of the financial crisis. Unemployment is stubbornly high in a number of countries, and productivity growth has been weak, especially in services. While some countries have successfully brought about changes from reforming labour markets to overhauling education systems or making the government apparatus more efficient, their example is not often and not fast enough followed by their fellow EU member states. Economic performance among the different countries varies widely. The outcome of the June 2016 referendum in the United Kingdom has raised numerous questions about future integration that may take months and years to answer.

Against this background, the McKinsey Global Institute in March 2016 launched a European essay prize contest. The idea sprang from the most recent MGI report on the continent's prospects and challenges, *A window of opportunity for Europe* (see Box: "Main findings of MGI's June 2015 report on Europe").

While our report explores the "why" and the "what" of European reform, we were aware of a missing dimension: the "how". To fill that gap, we decided to sponsor an essay prize that would crowdsource the best ideas from around the world about what was needed to translate economic theory into political measures that are both appealing to voters, and will help restore Europe's dynamism. We launched the contest before the United Kingdom voted in June to leave the European Union. That referendum gave added urgency to the search for solutions, and was frequently cited by essayists.

We received more than 400 essays from around the world by the deadline of July 31, 2016—and entries by authors under 30 years in age were plentiful, and among the best. Overall, the essays touch on a wide range of subjects, from investment and fiscal stimulus, to labour reform, civic engagement, and harnessing the opportunities presented by digital technologies. Authors have varied backgrounds, including in business, academia, and from policy groups. In his report that follows this preface, the distinguished chair of the judging panel, Pascal Lamy, discusses how we whittled the submissions down to a short list, and then selected the winners.

This booklet contains full versions of the three essays deemed most worthy by the jury. Two of them share the main prize, and the third essay is the best submission by an under-30 author. We are also publishing a thematic summary of the broader set of essays submitted, to give an indication of the breadth and depth of the ideas developed and presented, and highlight 20 of the best ideas. In general, these best essays provide a succinct analysis of challenges to be overcome, the policy recommendations needed to tackle them, and a range of implementation strategies and tactics to win over the hearts and minds of a European public grown sceptical of the gulf between grandiose rhetoric about European integration and policy outcomes they judge inadequate. The outpouring of suggestions in these essays comforts our belief that, despite the continent's difficulties, there is no shortage of ideas or enthusiasm for Europe. Indeed, the contest results confirm the findings of surveys we conducted in eight EU countries as part of our research; they show there is a public eagerness and desire for change across Europe.

While the 2016 MGI essay contest is now complete and the prizes awarded, our efforts to promote growth-oriented reform policies in Europe and stimulate a broad debate are still underway. We will circulate the winning submissions and some of the best other ideas widely among European decision makers and the public. We hope that this will galvanize much-needed new thinking about how European countries and institutions can raise their performance to a level that corresponds to the aspirations of citizens. The crucial next step is to transform ideas into initiatives.

This Europe essay contest is a crowdsourcing exercise to elicit bright ideas from around the world. The views expressed in the essays including the winning entries are solely those of the authors in their private capacity and do not in any way represent the views of McKinsey & Company or of MGI.

We welcome your feedback, at **EssayForEurope@McKinsey.com**

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October 2016

MAIN FINDINGS OF MGI'S 2015 REPORT ON EUROPE

The idea for this essay contest was sparked by the MGI report *A window of opportunity for Europe* published in June 2015. While Europe's growth has been sluggish since the 2008 financial crisis, our research found that, thanks to a convergence of low oil prices, a favourable exchange rate, and quantitative easing by the European Central Bank, Europe has a window of opportunity to undertake ambitious reforms, stimulate job creation and investment, and unlock new economic dynamism.

The report found that Europe could close its output gap, return to a sustained growth rate of 2 to 3 percent over the coming decade, unleash investment of €250 billion to €550 billion a year, and create more than 20 million new jobs. This would have a cumulative effect greater than the entire current size of the United Kingdom's economy by 2025 compared with a slow-reform, slow-growth scenario.

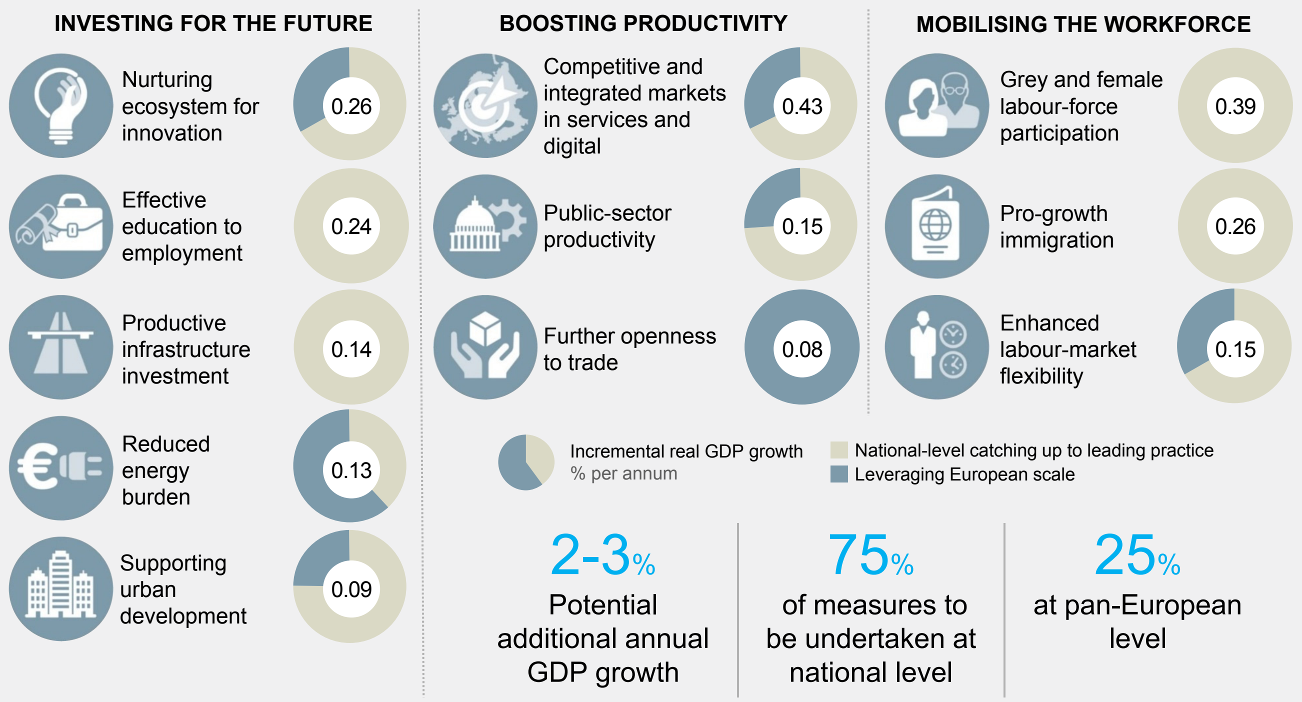
To achieve this goal would take a combination of structural reforms, about 75 percent of which would be made the national level, in lockstep with measures to stimulate demand at the European level. Three areas of reform with 11 growth drivers—many of which policy makers already implement in some form—could help deliver on European aspirations. While our report focused on what measures could achieve faster growth, we felt there was a need for fresh thinking about how pro-growth reforms could be implemented. This led us to create the prize essay contest.

The growth drivers in the report are (Figure 1):

- Investing for the future (for example, nurturing innovation and reducing the energy burden)
- Boosting productivity (for example, competitive and integrated markets in services and digital and more openness to trade), and
- Mobilising the workforce (for example, increasing grey and female labour-force participation and enhancing labour-market flexibility).

FIGURE 1

Eleven growth drivers can boost growth to 2-3 percent annually. About 75 percent of the measures can be carried out at the national level.



SOURCE: McKinsey Global Institute analysis

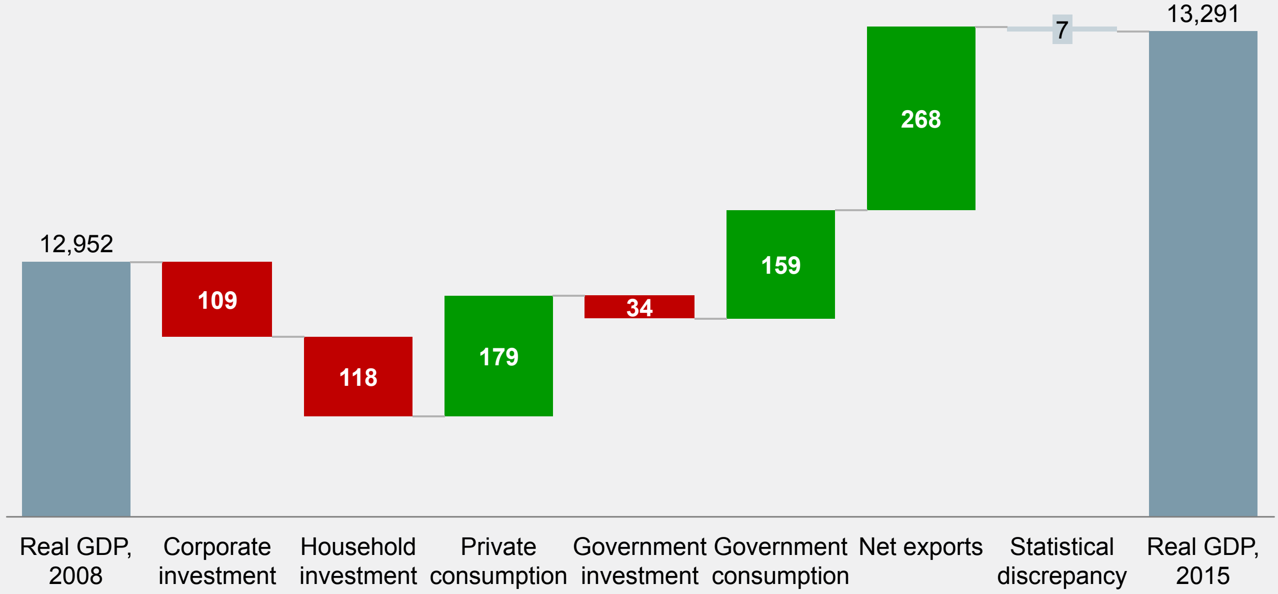
Approximately three-quarters of the total impact of the growth drivers would come from productivity increases and the remaining one-quarter from increased labour-force-participation rates and immigration. Best practice on every key dimension of the economy can be found somewhere in Europe. The challenge is to emulate that best practice and adopt it more widely.

However, with demand weak—output is still 15 percent below what it would have been if pre-crisis trends had continued—structural reforms alone are not sufficient. Investment fell sharply after the financial crisis and still has not recovered to pre-crisis levels, despite the uptick in growth since publication of our report (Figure 2).

FIGURE 2

Europe has thus far relied on exports to drive its recovery. Government, corporate, and private **investment has fallen.**

Change in real GDP, 2008–15
€ billion, chain-linked 2005, Europe-30



NOTE: No split of investment (gross capital formation) by source in Eurostat; government/household/corporate split from European Commission AMECO database applied to Eurostat total investment figures. Numbers may not sum due to rounding.

SOURCE: Eurostat; AMECO database; McKinsey Global Institute analysis

In terms of efforts to stimulate demand, Europe has been far less aggressive—and slower—than the United States, and its recovery has been weaker. Europe has several options for reigniting investment and job creation. Measures to unlock financing and quantitative easing can help but are insufficient on their own, our research found. Fiscal stimulus is not easy to implement at scale in Europe. New ideas need to be explored, including accounting for public investment as assets depreciate rather than during capital formation, careful adjustment of taxation and wage structures, or unleashing the silver economy.

Other MGI research has since confirmed Europe's potential to accelerate growth, including a June 2016 report on the potential boost to the economy from more rapid adoption of digital technologies. That report, *Digital Europe: Pushing the frontier, capturing the benefits,* found Europe in the midst of a digital transition driven by consumers, thriving digital hubs, and some world-beating digital firms. But Europe's digitisation remains uneven, and the continent operates below its digital potential.

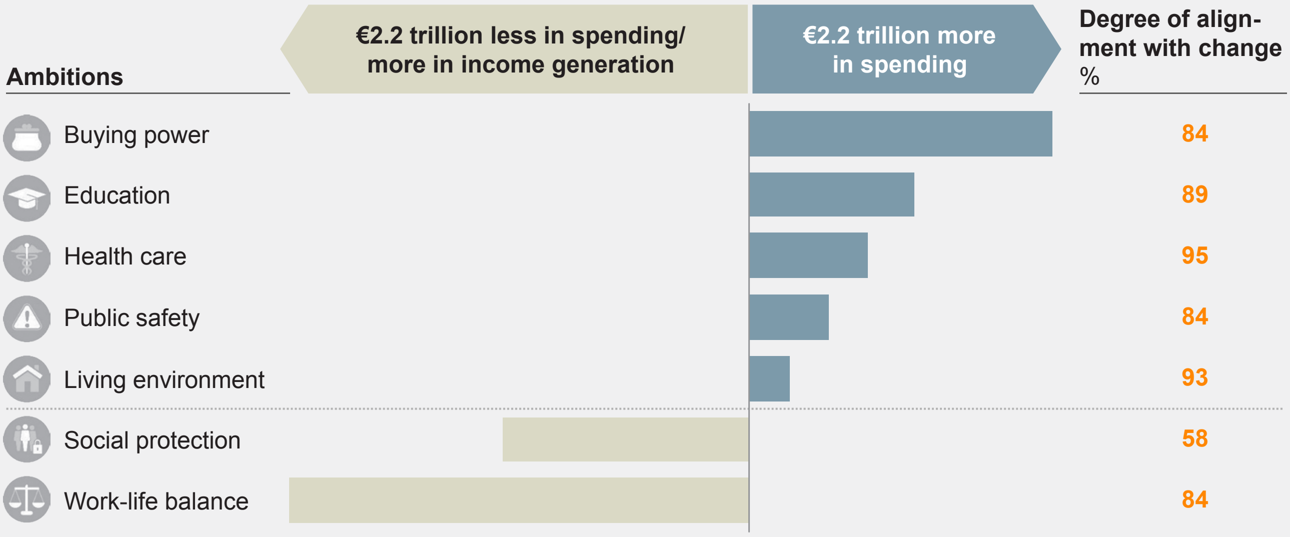
Beyond leadership and vision, reform at the national level requires European support for investment and job creation to be successful and palatable. And action to support demand at the European level requires trust and the right governance structures and mechanisms that avoid moral hazard, bundle tight package deals, or lift investment programmes to the European level.

Solutions exist outside a federal structure, and citizens seem willing to play their part. In a survey of 16,000 Europeans in eight countries that was part of our research, a clear majority of respondents said they would be willing to make trade-offs such as working longer or spending less on social protection in return for higher disposable income and greater spending on health care, education, safety, and the living environment (Figure 3).

FIGURE 3

European survey respondents have **high aspirations for growth** and incomes, and are willing to make tough trade-offs to achieve them.

Preferred trade-off of European respondents in 8 countries[1]
Additional spending and income generation (15% of Europe-30 GDP)



91% of European survey respondents prefer this scenario to the status quo

1 Calculated based on Europe-30 2013 GDP and GDP-weighted conjoint scores for eight surveyed countries with 2,000 responses each.
SOURCE: MGI European Aspirations Conjoint Survey, August 2014; McKinsey Global Institute analysis

The conclusion of our report was that, while it may be tempting for some observers to write off Europe, that would be a mistake. The continent has a foundation of strength on which to take action. It remains a world leader on key indicators of social and economic progress; think of Germany's trade competitiveness, France's world-class transport infrastructure, Portugal's record on bringing women into the workforce, Poland's resilience throughout the crisis, Estonia's adoption of digital technologies in the public sector, and Denmark's energy efficiency. Moreover, European economies are well connected to global flows: half of the 20 most competitive economies in the world are European. Despite the difficult economic environment, many companies continue to thrive and compete on a global scale. Furthermore, some European economies have made progress in the past few years on crucial structural policies needed to underpin future growth. However, at a time of slower global growth, and a wide range of challenges inside Europe, the window of opportunity for growth that exists is a narrow one, and European leaders need to move quickly and decisively to take advantage of it.

REPORT OF THE CHAIR OF THE JUDGING PANEL

The McKinsey Global Institute's "Opportunity for Europe" prize contest issued a call for essays in March 2016. The question to be answered was: "How could a pro-growth reform programme be made deliverable by 2020, and appeal to electorates and decision makers alike at the national and European level?" Submission deadline was July 31.

401
submissions in total

We received 401 submissions in total, from a highly diverse group of authors. This diversity is geographic, professional, and thematic. Authors live in countries from Belgium to New Zealand and the United States. While the largest share of essays—64 percent of the total—come from Europe, 13 percent are from North America, and Asian and African entries both amount to 11 percent. We also received essays from the Commonwealth of Independent States (9 percent), the Middle East, and Latin America (2 percent each). The authors' backgrounds are also highly diverse. They include 32 senior private-sector executives, a similar number of policy makers, 20 university professors, and more than 100 students, including 30 working on PhDs. Almost half of the authors are under the age of 30.

Thematically, too, there is a wide variety of ideas, as a summary later in this booklet details. The decline in government, corporate, and household investment since the 2008 financial crisis is a major focus of essayists, many of whom cite tight fiscal policies and insufficient economic stimulus in the European Union as holding back growth. Others identify structural issues, especially labour market rigidities, which have contributed to weak employment growth and a lack of dynamism in the EU. Whatever their diagnosis, a common refrain is that Europe currently lacks an imaginative vision or a clear sense of purpose, that its leaders can seem aloof from the daily concerns of ordinary people, and that, in a changing world, the very idea of Europe no longer inspires or comforts ordinary citizens. "Europeans don't fear change, they just fear being left behind by it," as one essayist put it.

THE JUDGING

The rules stipulated that contributions should be original and not previously submitted essays of maximum 5,000 words in length. They should propose tangible reform programmes, where the focus is on whether, how, and why they are politically feasible within three to five years and appeal to public opinion. They should also propose mechanisms, communications, packaging, institutions, or other ways that help build trust and avoid moral hazard.

In the six weeks following the deadline, 50 reviewers including McKinsey consultants and researchers and external researchers from organisations such as the Jacques Delors Institute and the World Bank read the essays in a double blind procedure. The identity of the authors was entirely hidden from view until the final judging was over. Overall, these reviewers carried out more than 1,000 individual reviews, and scored the essays out of a maximum of five points based on a number of criteria. These are whether the topic is relevant and impactful; whether the proposal is innovative and insightful; whether the argument is fact-based and well written, whether the proposals are politically and economically feasible and attractive, and whether the authors are mindful of growth, environmental, and social implications. The 96 essays that scored 2.5 out of 5 or above on average from the first two reviewers were given a third review, and the top quality 50 essays were reviewed once again by senior reviewers. The top 10 receiving the highest marks were then sent to the judging panel, along with five others that were deemed noteworthy because they were particularly innovative, or because they had received high marks from some but not all reviewers.

The judging panel comprises a cross-section of European opinion. Biographies of the judges are in section seven of this booklet. The members are:

- **Etienne Davignon,** Minister of State, Belgium, former Vice President, European Commission, and President, Friends of Europe
- **Henrik Enderlein,** Associate Dean and Professor of Political Economy, Hertie School of Governance, Berlin
- **Reiner Hoffmann,** President of the German Trade Union Confederation (DGB), Berlin
- **Eric Labaye,** Chairman of the McKinsey Global Institute, Paris
- **Andrew Palmer,** Business Affairs Editor, *The Economist,* London
- **Geneviève Pons,** Director of WWF European Policy Office, Brussels
- **Sven Smit,** McKinsey Western Europe Regional Leader, Amsterdam
- **Ewa Szmidt-Belcarz,** CEO of Empik, Warsaw

PRIZE WINNERS

The judges convened in Brussels on September 23 to discuss the entrants and select the winners. They awarded the prize to two entries, by Professor Volker Brühl, managing director of the Centre for Financial Studies at Goethe University in Frankfurt, Germany, and Dan Ciuriak, director and principal of Ciuriak Consulting. in Ottawa, Canada. The prize for the best essay by an author under the age of 30 goes to Antoine Levy, a 23-year-old French national who is currently a PhD candidate in economics at the Massachusetts Institute of Technology. Professor Brühl and Mr Ciuriak share the €60,000 prize equally. Mr Levy receives the under-30 prize of €25,000.

The two winning entries represent quite different approaches to reform—one more traditionally programmatic, the other more disruptive. The jury decided to split the first prize between them to recognise a combination of exciting, bold ideas with a more immediately feasible down-to earth reform programme. Their distinctive approaches reflect the wide range of proposals in the contest as a whole, and underscores the jury's belief that different strategies, including unorthodox ones, need to be examined and discussed if Europe is to restore its economic vitality.

The ideas expressed in all the essays including the winning entries are solely those of the authors and do not reflect individual or collective views of the judges.

Professor Brühl's essay, "Three cornerstones of a European growth initiative," proposes a three-pronged strategy comprising a national growth and investment programme, a pan-European cluster strategy, and a modified "Fiscal Compact" to unlock additional investment. The essay is a solid, well-documented, and feasible strategy that combines large-scale investment and significant structural reform, and we believe it makes a very useful contribution to the debate on reigniting economic growth.

Mr Ciuriak's essay, "Rebooting Europe," proposes radical monetary shocks to unblock European investment and restore growth. He advocates ending quantitative easing and raising interest rates to achieve a repricing of labour relative to capital; canceling excess public-sector debt in heavily-indebted European countries without worrying about moral hazard implications during times of crisis like the one we are in; and reorienting industrial policy to stimulate public investments. We were impressed by the audacity of the ideas, which we consider provocative and well argued, even if not easily implemented. The essay is effective precisely because the ideas expressed are very different from dominant thinking in the European Union today.

Mr Levy's essay, "Reforming Europe by the people, for the people: An adaptive, acceptable, and accountable reform programme," is a lucid and nuanced attempt to tackle the key political economy question of how to make reforms in Europe palatable to a disenchanted public. It displays a good understanding of the problem context and suggests interesting and original solutions, including ways to compensate individuals and groups who lose out as a result of structural reform. One of its strengths is that it seeks to reconnect ordinary citizens with the broad idea of Europe.

The three essays are reprinted in full in this booklet.

The prizes were announced publicly and awarded in Brussels on October 12, 2016, at the annual Presidents' Dinner hosted by Friends of Europe, the think tank partner for this contest.

As the president of the judging panel, I would like to express particular gratitude to my fellow judges for their enthusiasm about this initiative and their considerable contribution to making it a success. My sincere thanks to all those who submitted entries—and warm congratulations to the winners.

Pascal Lamy
Chair of the MGI Essay Prize judging panel
President Emeritus of the Jacques Delors Institute
Former Director General of the World Trade Organization
Former EU Commissioner
Paris

AN OPPORTUNITY FOR EUROPE: KEY THEMES OF THE PRIZE ESSAYS

Ideas about how to strengthen Europe's economy and cohesion were legion even before the famous 1950 declaration by Robert Schuman, France's foreign minister, proposing the creation of a European Coal and Steel Community, precursor to the European Union.[1] Since those beginnings, European leaders have traditionally taken up the task of devising and implementing reforms; indeed, some of the boldest and most comprehensive programmes for Europe's future are to be found in the European Union's own policy statements.[2] But over the past decade, as economic growth has slowed and European policy makers have grappled with the global financial crisis, the Eurozone's sovereign debt crisis, a resurgence of terrorism, and the mass influx of refugees, calls for larger reforms than governments seem able to agree upon or implement have become louder and more insistent. Suggestions for what is needed vary widely.[3]

For those authors submitting essays to the 2016 McKinsey Global Institute prize contest, the challenge has been not just to identify obstacles to stronger European economic growth and propose innovative solutions to them, but also—and this is an essential point—to propose mechanisms that ensure their ideas are implemented. The question we posed was, *how could a pro-growth reform programme be made deliverable by 2020, and appeal to electorates and decision makers alike at the national and European level?*

The best essays, including the 15 that were shortlisted for consideration by the judging panel, contain a mix of novel ideas and interesting implementation suggestions. The ideas range widely, from launching a European software app that helps people find jobs to issuing bonds as a way of managing migration. Some of the ideas involve creating new or extending existing institutions and mechanisms. They include appointing a European Commissioner for citizens whose mandate is to speak for ordinary people, establishing a public procurement advisory "hub" focusing on innovation, or extending the successful Erasmus student-exchange programme to include young professionals and high school students. However, as a number of authors make clear, even good ideas and clever ways to put them into practice will not suffice. New approaches to political communication, to restore public support and confidence in the European idea itself, are also called for.

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1 The Schuman Declaration of May 9, 1950 is published in full on the European Union website, www.europa.eu. The vision of a peaceful, prosperous, and united European continent was aired periodically in the 19th century, including by the French writer Victor Hugo, who called for a "United States of Europe," at a peace conference in Paris in 1849.

2 For example, the goal of the 2000 Lisbon Agenda was to make the European Union "the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion." The most recent comprehensive set of proposals is *The five presidents' report: Completing Europe's economic and monetary union,* European Commission, June 2015.

3 See for example, Henrik Enderlein, Joachim Fritz-Vannahme and Jörg Haas, *Repair and prepare: Strengthening Europe's economies after the crisis,* Jacques Delors Institute, January 2015; Joseph E. Stiglitz, *The Euro: And its threat to the future of Europe,* Penguin Books, September 2016; Jean Pisani-Ferry et al., *Europe after Brexit: A proposal for a continental partnership,* Bruegel, August 2016.

This summary of the prize submissions focuses on three main aspects. First, we identify the issues that authors consider most in need of addressing. Second, we provide an overview of the types of measures proposed to address those issues. Finally, we detail implementation mechanisms that ensure proposed solutions do not simply end up gathering dust in a drawer. This summary is not an exhaustive synthesis of the entries, but rather an examination of the major themes, and an outline of some of the more innovative proposals for resolving them. We have highlighted a number of the most interesting ideas with citations from individual essays.

IDENTIFYING EUROPE'S CHALLENGES

While European Union countries collectively have seen an uptick in GDP growth in the past few months, helped in part by lower oil prices, a weaker currency, and the continued monetary easing by the European Central Bank (ECB), a common refrain among the essayists is that Europe continues to underperform, and is falling well short of its growth potential. The judgments are often both harsh and nuanced. While some blame policy failings, a substantial number focus on a larger lack of vision or sense of purpose. "The EU, we concluded, is not short on ideas to implement or on good ideas being implemented. The disconnect appears to be one concerning inspiration," one author writes. "There has been too much long-run strategising to propel the European wagon on a high-road strategy," writes another, "but not enough myopic operational moves to actually ignite the motor." Fairly or unfairly, Brussels and the European Union have an image problem. "Undermining Europe's growth drivers is a dangerous counter-narrative which is gaining momentum, one that portrays the EU as an inefficient sovereignty thief, hell-bent on generating wealth for a rich "elite" at the expense of the people of (insert any member state here), and the problems and tensions associated with increasing globalization are blamed on the EU," is how one essayist puts it.

More than one third of the essays—easily the largest proportion—concentrate on ways to restore investment in the European Union, noting the steep decline in investment by business, households and governments since 2008. Several authors examine the causes of that decline in investment, and tend to blame tight fiscal policy or the inadequate effectiveness of monetary stimulus. Other reasons given are over-regulation that deters private investment, or insufficient capitalisation of small- and medium-sized enterprises, which do not have the financial means to raise their investment.

A second set of diagnoses of Europe's ailments focuses on structural impediments in national economies. Foremost among these are rigidities in labour market regulation and practices that numerous authors blame for continuing high unemployment and a lack of economic dynamism in many EU countries. Almost one in five of the essays cites lack of labour reform, highlighting the perception that this area remains one of the primary challenges facing the European Union. The judgment is often a blanket one covering the entire EU, although official unemployment statistics show a wide disparity in the number of jobless by country, ranging from 5 percent or below in Germany, the United Kingdom, and the Czech Republic, to 10 percent and above in France and Italy, and double that proportion in Greece and Spain.[4] Essayists identify other structural issues including product market barriers that impede trade, and legal or regulatory hurdles that make it unnecessarily difficult to set up businesses in some European countries.

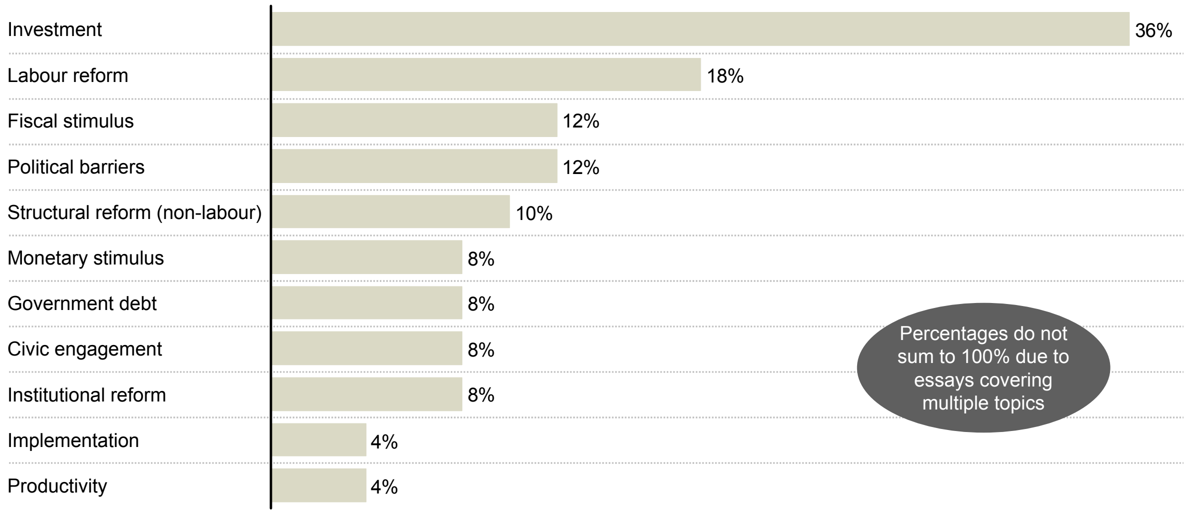
Immigration, one of the most topical issues in Europe today, is also addressed, with essayists putting the emphasis on ways to ensure a continuing influx of migrants, but in a manner that is controlled and that ensures the immigrants can find gainful employment without creating ructions in domestic labour markets.

[4] Unemployment data from Eurostat.

A third cluster of challenges centres on European institutions themselves. There is a clear division between those authors who see more effective and more integrated institutions as a solution to revitalizing the European economy, and those who view the institutions themselves as an impediment, arguing instead for the restoration of some powers to national governments via a new look at, and tougher enforcement of, the principles of subsidiarity. Whichever side of this discussion the authors take, they tend to share a common diagnosis, namely that defiance and distrust of the political ideal of "Europe" is rife, and that whichever measures are adopted need to "recreate a sense of ownership", in the words of our under-30s prize winner Antoine Levy. Europe, in other words, is widely deemed to have lost its mojo, and regaining it will be essential to restore economic health, alongside political and social cohesion.

ESSAY TOPICS AT A GLANCE

Submissions to the MGI essay prize touched on a large number of topics, but several were recurring ones, primarily issues relating to investment and fiscal stimulus, as well as structural reforms. The exhibit below shows the relative weight of different topics in the top 50 essays. It is representative of the submissions as a whole.



In this chapter, alongside our overall discussion of the ways in which authors suggest tackling these topics, we call out 20 specific proposals that we highlight with verbatim text. These struck us as being among the most interesting ideas. The numbers refer to the boxed quotations and do not represent any type of ranking:

1. A European TARP fund to restore bank health
2. Taking into account private-sector savings in assessing fiscal constraints
3. Three pillars of growth: national investment strategies, European clusters, and a modified "Fiscal Compact"
4. Rebooting Europe's monetary and industrial policy, including canceling debt and normalising interest rates
5. A formula that ties monetary policy to output gaps
6. Global central bank purchases of climate change "war" bonds
7. Tax exemptions for foreign investment in countries running a current account deficit
8. A pan-European digital platform for job-matching
9. A concerted focus on connecting health services
10. Banning non-compete agreements
11. An open innovation platform using gaming techniques
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13. A dual-track retirement benefit system to encourage the elderly to continue working
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20. A "Europeans for Europe" investment fund

PROPOSING INNOVATIVE SOLUTIONS

While a number of the proposals outlined in the essays focus on a single issue, most submissions bundle together a number of ideas, sometimes as a cohesive strategy, and sometimes as a series of not always related measures whose power lies in their cumulative effect. Frequently, the glue binding ideas together is the smart deployment of digital technologies, which are seen as enablers of reform that can help overcome traditional obstacles to change.

Drawing on best practices that have already proven their value elsewhere, whether in Canada, Sweden, Switzerland, Turkey, or the United States, is a second way our authors choose to glue together disparate ideas. The idea of creating a "best practice club" was one that featured in the 2015 MGI report on Europe, which was the spark for the essay prize itself. Some cite other MGI reports, including recent research about the state of digital technologies in Europe, which highlights progress Europe has made towards realising its digital potential—and measures how much more room it still has to extract greater value.[5]

The following are principal themes that emerge from the essays:

Increasing investment and stimulus, including by bypassing EU fiscal constraints

Calls for higher spending have been a frequent refrain in European politics in recent years, but the issue bogs down once the question turns to where the money should come from. If one country spends money that is de facto or de jure earned or guaranteed by another country, how can you avoid "moral hazard"—a lack of incentive to guard against risk. Some of our essay contestants grappled with ways to overcome, or bypass, the continuing objections to joint financial mechanisms such as Eurobonds, and the rules of the EU's "Fiscal Compact", which limit government deficits to a maximum of 3 percent of GDP and total public debt to 60 percent of GDP, but at the same time avoid moral hazard and fiscal irresponsibility.

Deleveraging to restore bank lending

With European economies burdened by sharp increases in their debt loads since the financial crisis, some contestants propose radical attempts at deleveraging, to free up new funds for investment.[6] One such proposal advocates creation of a public fund akin to the "Troubled Asset Relief Program" implemented by the United States following the financial crisis. This would purchase non-performing loans off the balance sheets of European banks, as a way of restoring them to health and, as a consequence, spur an increase in lending. The aim is to bring non-performing loans down to about 5 percent of total bank balance sheets. Weak banks would be obliged to sell part of their portfolios to the fund. Moral hazard could be avoided if equity holders and junior credit holders take a haircut in the operation.

1. A European TARP fund to restore bank health

"The fund could be set up either by the entire Eurozone or only a subset of countries and banks. Funding would also be voluntary, via a mix of EU money, member state contributions, and private capital. The fund would be a "for-profit" enterprise, ensuring Germany and other creditor countries' taxpayers that this would not be a bail-out of the banking system, but rather an orderly restructuring for which they would be rewarded if they participate. The ECB could set a mandate for European banks to bring down their non-performing loan ratios to a more sustainable level over the medium term. Banks would be encouraged to offset their NPLs in an orderly fashion to the European TARP, so as not to instigate a fire sale. This fund could then slowly unwind these large NPL portfolios over the course of a decade or more."

– *Europe: A positive vision for the 21st century,* **Tewfik Cassis,** United States

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[5] *Digital Europe: Pushing the frontier, capturing the benefits,* McKinsey Global Institute, June 2016.

[6] The sharp increase in debt since the financial crisis is not limited to Europe. See *Debt and (not much) deleveraging,* McKinsey Global Institute, February 2015.

Relaxing EU fiscal constraints to provide stimulus and increase public investment

For those of our essayists who advocate a relaxation of fiscal rules in the EU, the question is how to make such a relaxation politically or financially palatable. One proposes that the EU can overcome the rigidities of its fiscal rules by shifting to "golden rule" budgeting. This would replace fixed fiscal targets, such as the 3 percent ceiling on budget deficits, with a more flexible arrangement under which governments take a longer view and operate on the principle that they should only borrow to invest. Golden rule policies, which broadly state that over an economic cycle government should only borrow to invest, are a useful middle-way between fiscal targets that are clearly defined and at the same time preserve the crucial fiscal policy flexibility needed to react to unexpected circumstances. By comparison, Europe's insistence on sticking to its financial targets contributed to a double-dip recession in 2012, as pinched spending aggravated already depressed demand. The same author also proposes creating a "sovereign wealth fund" for the Eurozone to create a fiscal capacity that could help absorb asymmetric economic shocks. This could be financed by issuing some form of joint liability bonds taking advantage of low interest rates in private markets, and possibly mechanisms involving the European Central Bank.

Another author proposes that any limitations to fiscal positions should take into account private-sector savings, since the level of these savings in countries including Spain, Portugal, and Italy is sufficient to support fiscal expansion of 6-8 percent of GDP in most periphery countries without external financing needs. Drawing on the work of Richard Koo, the author suggests issues of moral hazard could be avoided if there is a stipulation that only national citizens are able to buy domestic debt, thereby recycling their savings domestically.

2. Taking into account private-sector savings in assessing fiscal constraints

"A better way forward would be to adopt a balance sheet recession approach to the problem. This means understanding that a number of Eurozone countries, especially those of the periphery, are in so-called balance sheet recession—a situation in which individuals and companies, usually following the burst of a debt-financed bubble, collectively focus on saving rather than spending, thus reducing aggregate demand—and should thus be allowed to pursue much more expansionary fiscal policies until private-sector balance sheets are repaired. More specifically, it means that private-sector savings levels have to be taken into account when evaluating the 'optimal' fiscal stance of member states. Unfortunately, the EMU's current budgetary rules make no provision for this type of recession. As a result, the large and unfilled deflationary gaps between private-sector savings and public-sector borrowings triggered deflationary spirals that effectively pushed a number of countries off the fiscal cliff, with devastating consequences for their economies and their peoples. The amount of time that the peripheral private-sectors are taking to repair their balance sheets has been far beyond anything that was anticipated by the Maastricht Treaty. According to 2015 flow of funds data, private-sector savings amounted to 10.8 per cent of GDP in Ireland, 7 per cent for Spain, 6.8 per cent for Portugal, and 6.3 per cent for Italy. This means that there are sufficient levels of excess (i.e., unborrowed) savings to support a fiscal expansion in the order of 6-8 per cent of GDP in most periphery countries. It is often argued that German taxpayers would never sanction a fiscal stimulus in periphery countries, but the existence of huge pools of private savings in those countries means that if those savings were to return to the domestic government bond markets, the ultimate cost to the German taxpayers would be zero. That said, periphery countries need to ensure that idle savings in these nations do not flow abroad —we are already witnessing the return of intra-EMU capital flight, as tensions build up once again in periphery banking sectors—but are invested in local government bonds. This can be achieved by 're-internalising' fiscal policy in the EMU: i.e., by limiting the sale of government bonds to each country's citizens. In other words, only German citizens would be allowed to purchase bunds, only Spanish citizens would be able to buy Spanish government bonds, and so on. The new rule would also resolve the capital flight problem by preventing Spanish savings from flowing into German bunds."

– *Strange bedfellows: Reconciling national fiscal policy with monetary union,* **Thomas Fazi and Guido Iodice,** Italy

One of the prize-winning essays, by Professor Volker Brühl, proposes modifying existing accounting of public investment so that only the yearly depreciation rate of public investments is taken into account for the calculation of annual budget deficits in the "Fiscal Compact". For now, there is no difference in treatment between government expenditures for administrative costs, subsidies, or other transfers, and government investments in infrastructure or research and development. Professor Brühl calculates that counting only depreciation of public investments could free up large amounts for additional public investments.

Assuming that the financing is taken care of, what form should a surge in investment take? Specific ideas include a coordinated approach across European countries. Professor Brühl proposes a European growth initiative consisting, on the one hand, of national growth and investment programmes and, on the other hand, a pan-European "cluster strategy." The national programmes would encourage countries to build out sectors where they have competitive strengths, commensurate with the state of their economic development. For example, some of the least developed European nations could focus on growth areas including agriculture, tourism, or basic industries. More developed countries could invest in logistics, telecommunications, and modern government architecture as a way to attract foreign investors and build out their manufacturing and service industries. The most mature economies could focus on digital business, biotech, green tech, and services. These national programmes would be accompanied by a strategy aimed at scaling up industry clusters from a national level to a pan-European one. Professor Brühl points out that the European economy currently is characterized by a large number of small clusters, and what is needed is to "connect the dots" to achieve critical mass, avoid duplicative investments, and raise the rate of innovation.

3. Three pillars of growth: national investment strategies, European clusters, and a modified "Fiscal Compact"

"A first pillar is for each country to develop its own strategic growth agenda ("National Growth and Investment Program", NGIP) based on its existing resources, skills, capital and innovation potential. The design of such an economic policy programme should aim to leverage competitive strengths and comparative advantages of the country in the best possible manner by aligning them with key success factors of the respective industry. Such a NGIP may include a broad range of measures including structural reforms, deregulation, privatisation, flexibilisation of the labour market and public investments in critical infrastructure.

NGIPs should be discussed with the EU Commission and be complemented by a pan-European cluster strategy. The importance of clusters – defined as agglomerations of interconnected businesses – as drivers and catalysts for economic development has been confirmed by empirical research. However, most cluster initiatives are currently being undertaken on a national level. Although the EU Commission already pursues cluster initiatives within its cohesion policy, a much stronger focus on a cluster policy backed by substantially higher financial investments is necessary to ensure global competitiveness of Europe particularly in emerging high growth industries.

The third pillar is a modified "Fiscal Compact" which allows the commitment of additional financial resources for public investments both on a national and a European level to regain trust by private investors and to break through the underinvestment climate."

– *Three cornerstones of a European growth initiative, "EU 2025",* **Volker Brühl,** Germany **PRIZEWINNER**
(Professor Brühl's full essay is reprinted later in this booklet)

Other essays propose large-scale spending not just on physical infrastructure such as roads, renewable energies or affordable housing, but also on critical enablers of future growth such as education and digital networks. Rather than focusing on "horizontal" approaches to investing in economic infrastructure, or "vertical" investment into specific sectors, our other prize winner, Dan Ciuriak, argues that European governments should develop risk/return metrics that will ensure public funding goes into promising ventures that would otherwise be unattractive to private investors.

Debt cancellation, helicopter money and other unconventional monetary measures

The European Central Bank (ECB) and its further room for maneuver are the focus of numerous essays. We pointed out in the June 2015 MGI report that the ECB has potential ammunition it could still use to deliver an even larger stimulus boost than its quantitative easing programme is already providing, including forms of helicopter money.

Prize-winner Dan Ciuriak makes the boldest proposal for further ECB action. He argues the ECB should buy "excess" public-sector debt, printing euros to pay for the purchases—

and then promptly cancel the debt acquired, without investors taking a haircut. Mr Ciuriak estimates that adding together the net debt of France, Greece, Italy, Portugal, and Spain above the 60 percent limit will amount to about €2 trillion. As for issues of "moral hazard" that this cancelation of the debt could cause, his argument is blunt: "Moral hazard? In crisis, ignore." The author backs up this assertion by pointing to some previous banking crises where moral hazard considerations led to decisions that were harmful. They include the closure of Indonesian banks during the Asian crisis, the bankruptcy of Lehman Brothers, and the reluctance by European governments to write off Greek sovereign debt—decisions which Mr Ciuriak believes merely exacerbated problems for the longer term.

The excess debt cancellation is one of two radical monetary policy suggestions. Mr Ciuriak also argues that the ECB's monetary stimulus to date, including its quantitative easing policy, has failed to spark interest-sensitive consumption and investment and instead has provided an artificial incentive to substitute capital for labour—with destruction of jobs. Mr Ciuriak's answer is to reprice labour relative to capital by raising interest rates.

4. Rebooting Europe's monetary and industrial policy, including canceling debt and normalising interest rates

"The European Union is mired in a bad economic equilibrium of stagnation and deflation – stag-deflation. While the problem is excess supply and inadequate demand, current policy, premised on private-sector-investment-led growth, aims to expand supply further through ultra-low interest rates. This is demonstrably not working. The reason is that it raises the cost of labour relative to capital, thereby destroying jobs and demand, which negates the incentive for private-sector investment. The next interest rate cut simply intensifies the deflationary pressures. At the same time, this policy is generating a debt burden that is a tinderbox for crisis. Incremental reforms will not work. Europe's policy settings need to be reset to a configuration that has worked in the past. This involves the following:

- First, re-price labour: recognising that monetary stimulus, including quantitative easing, has not triggered interest-sensitive consumption and investment but has priced labour out of factor markets (as interest rates fall, the ratio of wage rates to cost of capital rises), remove the subsidy for investment and price labour back into the market by normalizing interest rates.
- Second, defuse the debt bomb: since raising interest rates in the context of a debt bubble would lead to a crisis, have the European Central Bank buy up excess public-sector debt and cancel it. This would remove the tourniquet on fiscal policy, allowing a return to the job-creating expansions of the Keynesian era. Moral hazard? In crisis, ignore.
- Third, redefine industrial policy by addressing the problem of adverse selection of investment opportunities: the current consensus supports investments with risk/return metrics that appeal to the private investor, leaving on the table investments that do not, but that may have strong public good characteristics. There is money on the table; Europe should seize it to restore growth, using its new-found fiscal room to manoeuvre."

– *Rebooting Europe,* **Dan Ciuriak,** Canada **PRIZEWINNER**
(Mr Ciuriak's full essay is reprinted later in this booklet)

Other authors also urge the ECB to adopt radical unconventional monetary instruments, including "helicopter money." This is a reference to a famous suggestion by the US economist Milton Friedman that, if a central bank wants to raise inflation and output in an economy that is running substantially below potential, it could simply drop $1,000 bills out of a helicopter. The idea is that one of the most effective tools to boost household demand is simply to give everyone direct money transfers.

Many obstacles stand in the way of the use of helicopter money, including legal challenges, questions of democratic legitimacy, or governance issues around when to use monetary finance, and for what. To avoid monetary finance being continuously used for political reasons, one author proposes to link it specifically to output gaps.

5. A formula that ties monetary finance to output gaps

"There are implications of moral hazard and mistrust if governments are able to finance spending by printing money rather than taxing or borrowing. To solve these, we suggest a formula rather than a discretionary approach. For example, within the Eurozone, countries could agree that the ECB would, each year, provide one-third of a country's negative output gap in euros to the government, which could be used on public projects. This overcomes the problem of threatening central bank independence by making money financing non-discretionary, so governments could not put pressure on the ECB to provide them with money. This policy has the added advantage that it would not only help reduce the output gap, but it would also be inflationary and would not crowd out private investment."

– *Opportunity for Europe: A path to reform,* **Karl Nielsen,** United Kingdom

Other supporters propose changing ECB legislation, to establish long-term economic growth and unemployment reduction as its policy priorities while at the same time relaxing its long-term goal of controlling inflation at 2 percent. Money creation would be independently determined by the ECB and distributed to governments according to a predefined key, such as on the basis of member state population. Governments could use the money in accordance with the needs of their countries, be it stimulus, savings, or debt reduction. Addressing potential opposition by savers fearing inflation, the author suggests these changes be accompanied by the introduction and larger-scale adoption of inflation-indexed contracts for loans, deposits, bonds, rents, etc.

Even an ECB programme of helicopter money may not be enough, one author postulates. He proposes that it be accompanied by another measure to stimulate household demand: a public investment programme funded by low-rate loans from the European Investment Bank to member states whose specific purpose is to carry out specific pro-growth reforms.

Tying monetary measures to environmental and other policies

Helicopter money could be more palatable to sceptics if it is linked directly to efforts to tackle climate change or other policies deemed priorities. One author suggests issuing time-limited vouchers that are used to finance energy efficient investments, or similar schemes. Further credits could be given to countries for broader infrastructure investment. Another author suggests a "Climate Change War" (CCW) – a concerted effort to tackle the threats caused by climate change. According to the author, the International Monetary Fund and the World Bank should issue CCW bonds to finance climate-change-related projects, while central banks worldwide buy these bonds. At the same time, each government receiving allocations for CCW projects should underwrite a future tax commitment, off-balance-sheet, entering in effect after a duration of 10 years. Corresponding taxes should be raised as of year 10 to service the CCW bonds.[7]

6. Global central bank purchases of climate change "war" bonds

"This solution provides two critical elements, a credible global cause and winning time. By gathering the whole world against a common cause, we would generate both the high amount of confidence that was lacking and a tremendous amount of resources (human and financial) to invest. These resources would be raised and utilised from the IMF/World Bank balance sheet, and the utilisations would be allocated to individual countries but without creating any further burden to their respective public-sector finances. CCW would not trigger any dreaded reaction from capital markets as their servicing, via the CCW taxes levied at individual country level, will not be required during the first 10 years... Once arrived at year 10, hopefully we would be in a situation where balance sheets would be able to take the new CCW tax without fully offsetting growth. Then, governments would gradually pay back the bonds to the IMF and World Bank, who would pay back to central banks, who could then eliminate the excess cash created in the system. Thus in 30 years, we would be back to a healthy economic environment in a healthy planet. That is the legacy that we all want for our descendants."

– *Bleak optimism and slight hope,* **Angel Gavieiro Besteiro,** Abu Dhabi

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[7] A number of other authors suggested programmes aimed at environmental protection and energy efficiency that are not necessarily tied to helicopter money. Some of these involved additional fuel taxes aimed at curbing emission, making sustainability a key focus for EU programmes, or creating a risk-sharing mechanism for economic shocks that would link them to emissions trading schemes.

Helicopter money is by nature limited in time, and some of our essayists prefer a longer-term approach. One solution proposes tying together different European policy goals by reinforcing and relaunching an existing EU programme, the Capital Markets Union, and linking it explicitly to other initiatives including ones on tackling climate change or achieving the United Nations' Sustainable Development Goals. Responsible investment and environmental, social and corporate governance goals will become an explicit part of the fiduciary duties of international investors, under this proposal, and companies will need to embed responsible investing principles in their operations on a "comply or explain" basis. This will create clear incentives for pension funds and other institutional investors to orient their investments, potentially mobilising some of the €12 trillion held by European pension funds and insurance companies. Investors would have not only a responsibility to rethink the placing of their investments, but through the focus on social and environmental goals, they could improve their public image. Another author suggests repurposing the Capital Markets Union as a vehicle to revitalize capital flows within the EU—in particular venture capital financing flowing from northern Europe to Mediterranean countries, to promote productivity growth and restore competitiveness there.

Raising demand and competitiveness in the periphery

Some essays look specifically at how to raise demand in the most affected periphery economies. One proposal is fiscal devaluation: Lowering tax on labour income to regain unit labour cost competitiveness, at the same time as raising rates on consumption or capital income. Another argues for the creation of an incentive mechanism to attract massive inflows of foreign direct investment to the periphery of the Eurozone, assuming that this will be the fastest way to boost economic growth in the European South. Non-local companies investing in countries that run a current account deficit will receive a 10-year tax exemption, under this proposal, and they in turn could raise investment by issuing bonds whose coupon would be subsidised by governments.

7. Tax exemptions for foreign investment in countries running a current account deficit

"The strategy is based on the creation of a FDI incentive mechanism at the Eurozone level. The mechanism incentivises the flow of private capital from the Eurozone's surplus to the deficit countries in order to finance FDI projects, whose realisation it also incentivises, in the latter. It is the core-periphery bridge that is needed to make the periphery prosper while generating attractive returns for the core's current account surpluses. The result will be a balanced, resilient and prosperous Eurozone. A stable and prosperous European Union."

– *The Eurozone core-periphery bridge: a FDI driven pro-growth strategy,* **Rui Soares,** Germany

Digitisation to spur innovation and enterprise

While stimulus and investment are common themes, most of the authors proposing them concede that in themselves they would be inadequate to restore Europe's economic dynamism in a sustainable manner. For that to happen, stimulus would need to coincide with structural improvements in the functioning of economies. One needed aspect, many agreed, is true innovation, especially digital innovation.

Public-sector digitisation as a tool to spur efficiency, innovation, and transparency

Many of the essays suggest ways in which digitisation can spur innovation and efficiency, boosting growth in the process. This is certainly the case in the public-sector, according to the submissions. Several authors suggest that digitising government administration will give rise to major efficiency gains. Transitioning the public-sector onto digital platforms will both facilitate the interaction between government agencies, citizens, and businesses, and at the same time bring considerable savings that can be used for strategic investments.

For efficiency, an essential first step, one writer argues, is the digitalization of public-sector document databases, and the establishment of a unified workflow based on a shared integrated IT platform. This would speed up and streamline all interactions between citizens and public administration. A centralised platform that manages government procurement will achieve considerable efficiencies of scale, and thereby savings, this same author and some others argue. A European Digital Agency for open source software could advise and help public administrations across Europe make better use of free software, with potentially major cost savings and synergies. Such an agency, to be funded by all EU governments, would customise and create software to meet the needs of public administrations. Its scale would enable it to undertake the sizeable investments needed to digitise European governments.

For transparency, a European public streaming service that serves as a platform for public service broadcasting from all European countries would be a key information hub for policy makers and interested citizens alike. The purpose would be to give scale to the European media industry, show Europeans what a single digital market means, and improve the productivity of public broadcasters. A redesigned European Data Portal that regroups all EU governments' open data initiatives could open up government to public scrutiny on a pan-European basis. The portal would not necessarily hold a massive central database, but connect seamlessly to national databases. This latter measure could rebuild confidence in Europe as a whole, as well as bringing new transparency. "Europeans don't fear change, they just fear being left behind by it," the author notes. Another author suggests the creation of a European open access journal system to facilitate availability of scientific insights and thereby foster innovation. Initially, researchers would receive financial incentives to publish their results in open access journals, although in the long run, the author believes it could be possible to maintain an open access system without economic incentives.

For more efficient markets and matching, several authors propose the use of digital platforms – be they public or private-sector operated. One lists several use cases: a job-sharing platform that pulls together all open positions in the EU; an internship platform that links students and others seeking internships with employers offering them; and a "crowdfunding" platform that matches EU citizens who have business ideas with financial backers, but also with experts who can provide guidance, especially on legal and market issues.

8. A pan-European digital platform for job-matching

"The fundamental idea is to create a common shared platform for EU citizens which will put together all up-to-date information regarding available job positions on the EU market, candidates' profiles, as well as statistics and predictions for jobs in demand now and for the future. The basic distinction of the Single EU Job Board from already existing platforms is that it will merge all existing job platforms within EU member states into one (for example, with the help of spider technology which can gather all already existing offers and later on add new ones to our platform as they will appear on these sources). It will connect job hunters and job seekers from the European space, giving them an opportunity of wider choice of candidates and offers, respectively, by collecting all participants in one place. The Single EU Job Board as the aggregate source of job information will increase EU integration by facilitating labour movement among countries, including high-skilled labor; decreasing unemployment on the EU level; making the employment rate more equal between EU member states; increasing transparency both for employers and candidates; better matching of job seekers with the offers based on expectations of both parties, candidates' experience and employers' requirements on the EU level; knowledge transfer due to multinational environment in the companies. It will also provide precise statistics about the labor movement among EU countries, jobs/occupations in demand for each EU member state and so on."

– *Online platforms for effective education, mobilized workforce, and innovation boost,* **Valerya Papko and Elli Vitchynova,** Poland

Focusing public procurement on support for innovation

Digital or otherwise, public-sector procurement in the EU is an underused tool for boosting growth, and several authors discuss the need for better joint procurement. To achieve this, one submission proposes creating a European public procurement advisory hub that will focus on supporting innovation, especially by small and medium-sized enterprises in Europe. The author argues that it is not a lack of mechanisms or programmes but rather the lack of experience that limits countries from doing more with public procurement to promote innovation. An advisory hub will help governments make more coherent, strategic decisions in their procurement, by providing capability and sharing best practices. Among other things, this could help broaden opportunities for companies that produce high-value products and provide high-skill jobs. Another essay proposes a single-minded focus to connect health systems across Europe, creating a health research and innovation ecosystem that shares data, procures to innovate and harnesses digital technologies to knit together different national systems and increase efficiency.

9. A concerted focus on connecting health services

"Many of the building blocks needed to facilitate the adoption of Connected Health, tools such as ePrescribing, eReferral, and electronic health records, are available in almost three-fifths of all European countries. Furthermore, citizen services related to eHealth are present in 67 percent of these countries. So, we have a recognition of the problem and a willingness to act at a policy level, complemented by an array of available technology solutions. And yet adoption of connected health has yet to reach its full potential. In fact, health-care deliverers are unable to buy these seemingly ideal solutions because they find themselves trapped. Why? Lengthy and cumbersome public procurement policies strangle innovation by requiring detailed specification of the end result when the purchaser cannot yet know the ideal solution to their current problem. Meanwhile, those attempting to seel their wares face incredibly long sales lead times, numerous false stars, and resource-intensive tender processes that burn through their cash reserves at an unsustainable rate."

– *Connecting health, convincing hearts: A connected health infrastructure in Europe,* **Nicola and Robert Mountford,** Ireland

Boosting young and small companies

SMEs—defined as firms with less than 50 million euros in annual sales and a maximum of 250 employees—number more than 20 million in Europe and account for more than two-thirds of total employment, according to official statistics quoted by one writer. Particularly young companies are major drivers of economic growth and employment, generating all net new employment, and yet too often undercapitalised or lacking experience in the global economy. How could they be helped?

One proposal suggests creating business incubators across Europe to assist start-ups with legal, fiscal, and operational advice. These would help young companies from different European countries create cross-national networks and partner up towards common goals in such areas as marketing and business development, the author suggested. Another essay proposes a range of measures to encourage start-up formation, including talent scouts who would visit universities looking for interesting ideas, accelerated patent processes, special "entrepreneur" visas that would allow non-EU post-graduate students to stay, and tax exemption for capital gains from long-term investment in startup companies. In a similar vein, another essayist proposes creation of a digital platform with gamification at its core, on which EU-citizens can co-create and select innovative ideas. Selected projects would be up for crowdfunding by EU citizens, business angels, and a public money matching mechanism whereby each euro invested by an individual citizen would trigger an equal contribution by the relevant public bodies.

10. Banning non-compete agreements

"Much of the success of Silicon Valley is often attributed to the fact that non-compete agreements are not enforceable in California. Samila and Sorenson "find that the enforcement of non-compete clauses significantly impedes entrepreneurship and regional growth."[8] Non-compete agreements should be banned across all of Europe. A loss in employee training is to be expected, but it could be mitigated with national laws forcing new employers to refund recent training costs. Pressure against the provision is expected from businesses. This lobbying should be framed as an attempt to lower wages and stifle entrepreneurship."

– *Europeans first,* **Valentino Assandri,** Germany

[8] Sampsa Samila and Olav Sorenson, *Noncompete covenants: Incentives to innovate or impediments to growth. Management Science,* issue 57, March 2011.

11. An open innovation platform using gaming techniques

"The proposal is for a platform where all ideas can be freely co-created by any citizen in the EU. It seeks to have a large number of heterogeneous participants. Involving very different individuals, coming from various backgrounds and having distinct cultural traits, especially national cultures, in the EU context, is a great opportunity to foster "outside the box" thinking, and is more likely to lead to breakthrough ideas... Once an idea is soundly formulated, it goes through a selection process on the "one citizen-one vote" principle. To promote multidisciplinary approaches, the selection could be structured in a way that promotes ideas backed by a diverse audience in terms of professional background. This selection can ensure a very good adequacy between the market needs and the ideas co-created on the platform. To make it successful, one of the challenges is to engage citizens on this platform. To address this engagement challenge, gamification mechanics could be used, which would certainly lead to a broader range of citizens involved in the process. Contrary to a game, which is made to entertain users, gamification is made to engage them, using gaming mechanics such as collaboration, competition, and rewarding, to channel and coordinate participants. The gamification dimension could also allow to institutionalise the multidisciplinary and social diversity in the platform. Once a project is selected, it can be proposed to crowdfunding."

– *The intrapreneurial imperative,* **Pierre Serkine,** Belgium

One of the obstacles to small and medium-sized companies thriving across Europe is the multilingualism of the continent, which can often be a barrier to commerce and labour mobility. Here too, digital technologies could make a substantial difference. Thanks to breakthroughs in language processing technology, one layer of bureaucracy and protectionism that keeps the single market a series of monolingual fiefdoms could be eradicated. One essay proposes creation of an open-source plugin for developers to easily translate websites and apps. Other authors examine obstacles to innovation that cannot be fixed by technology. One suggests following the example of California and banning non-compete agreements.

Using prizes to drive progress

A significant number of authors propose competitions with prizes to encourage and stimulate innovation. Most of these are relatively small scale, but advocates argue that it would send a strong signal, namely that Europe is not simply passively regulating innovation, but actively incentivizing and investing in it. One of the most elaborate proposal is for a programme called "Eureka Europe," an annual contest with almost €1 billion in prize money.

12. "Eureka Europe" – An annual contest to spur innovation

"We suggest launching a Eureka Europe annual contest, assessed by a jury of independent experts. The winning prize will be €500m for the best new product/service for European consumers and for growth. This enshrines article 169 of the Treaty on the Functioning of the European Union (promoting 'consumers' interests') and article 3 (promoting 'technological advance'). The winner is bound to re-invest within one year half of the cash to expand her business internationally in order to create trade and foreign investments spillovers for Europe. Eureka thus complements and enhances the EU's COSME programme, which improves businesses' access to finance and markets.

In addition:

- €150m for the best innovation from a 'moderate innovator' country according to the Innovation Union Scoreboard (e.g. Poland, Hungary, Spain with innovation scores similar to developing Serbia's) to reinforce innovation across Europe.
- €150m and fast-track procedure at the European Patent Office for a project that improves/reinvents service delivery, because another key to unleash growth is to unleash services, which constitute 75 percent of Europe's economy.
- Solve-Me spinoff: each year, member states select the three most critical opportunities for European growth (e.g. migration) and the best ad-hoc solutions from the private-sector are awarded a €150m pool prize.

Finalists will get a one-year permit to test any new product or service which clashes with EU regulation. This is designed to amplify the geographical impact of Britain's "Regulatory Sandbox" and France's "Expérimentation" programmes, which temporarily grant a relaxed regulatory framework for certain breakthrough products. This will incentivise participation, ensure Europe-wide research spillovers, and alleviate the private-sector's perception that EU innovation budgets are too heavily specified/regulated."

– *Elixir Europe: Powered, palpable, and popular,* **Sofiane Croisier,** Belgium

Novel ideas about product and labour market reform

Digital applications can also be especially effective tools to tackle one of the major challenges that has long faced European economies—unemployment—as well as a more recent political and social preoccupation—immigration. As noted, the June 2015 MGI report detailed 11 growth drivers to tackle some of Europe's more intractable structural economic problems, from low labour participation among some groups and labour market rigidities that act as a disincentive to hiring, to challenges of public-sector productivity and lack of market integration. In our prize contest, essays that focus on structural issues largely pick up the areas where we had stressed the need for growth drivers, and propose solutions of their own.

Improved matching of workers

Numerous proposals focus on the use of digital technologies to reduce some of the existing market rigidities, especially hiring. Digital hiring platforms such as LinkedIn and Monster already exist in Europe, but some authors think there is much more to be done on a European level to match employers looking for skills with people who have those skills. For example, one author proposes the launch of a Europe-wide job "app" called "JobAroundMe", developed by the private-sector in cooperation with the European Commission, which would act like some existing dating sites: prospective job seekers would upload their profiles to the app, and employers would swipe right or left to match people in their vicinity to open positions.

Raising participation rates

Digital solutions are not the only ones. To counter relatively low participation of elderly people in the workforce, one idea is to give pension-age seniors tax reductions to stay on the job, delaying payment of their benefits – while leaving the official retirement age untouched to avoid expected opposition.

13. A dual-track retirement benefit system to encourage the elderly to continue working

"Elderly workers could be significantly encouraged to work through the legislative introduction of a fiscally sweetened "option to work" clause in the enjoyment of pension benefits by workers in Europe. This entails the reform of pension systems into a legally prescribed dual-track benefit system for senior citizens each with its own benefits. On the one hand, there would be a person who is above the legally defined retirement age, has consciously chosen to retire, and does not actively earn wage income and as such, enjoys the legally prescribed pension benefits from the state. On the other hand, is a person whom notwithstanding his having exceeded the legally prescribed retirement age chooses to defer his pensioner status and enjoys tax benefits as opposed to direct pension benefits from the state. The exercise of the "option to work clause" on the part of the individual automatically triggers tax waivers on his income while shutting out the traditional pension benefits from the state. A preferential tax rate of one-third of the tax otherwise payable on the specific income tax bracket of the senior working citizen is advocated. The proposed income tax benefits would only attach to income actually earned by the post-retirement age worker in the course of remunerated employment as distinguished from capital gains (to pre-empt tax evasion). In effect, a worker still reserves the right to retire at the legally prescribed age or at any age thereafter and enjoy his legally prescribed pension benefits. However, a worker can now choose to stay on in active employment and defer his pensioner status until he finally retires with a favourable tax treatment of his "extra income" being the incentive."

– *Heralding economic rebirth in Europe,* **Dasaolu Olawale Johnson,** Nigeria

Another focuses on a more thorough integration of women in the labour market through reforms including quotas for women in technical universities, as well as professional degree programmes and specific tertiary education programmes targeted to women. Female entrepreneurs would receive preferential procurement and tax treatment under this essayist's proposals, while parental leave benefits and childcare infrastructure would be upgraded.

14. Raising female participation in the workforce

"At present, women have lower rates of participation, higher unemployment, a greater incidence of part-time work, and lower pay. From an equity perspective, these facts are distressing; viewed through an economic lens, women who are currently not participating fully in the labour force represent a tremendous latent source for new economic growth. What's more, the policies needed to improve participation and pay—better education, harmonised leaves, childcare, training, and equal tax treatment—are well-established, politically popular, and fiscally neutral."

– *Women of opportunity,* **Joshua Morris Hurwitz,** United States

Incentivising greater worker mobility

Greater mobility in general is needed, argues another essayist, who proposes the creation of worker mobility scholarships with pre-defined payback conditions. The same author suggests greater institutional collaboration across Europe on labour integration, including the creation of an EU-sponsored platform for labour unions to collaborate, and the establishment of a European Ministry of Labour. Its mandate would be to implement the reforms required for a more integrated labour market and ensure wage adjustment across Europe when needed. Improved mobility is important not just for better matching of jobs and skills, but also for spreading enthusiasm for European integration more generally among working people. One essayist suggests the way to deal with this issue is by extending the EU's Erasmus programme, which currently covers exchanges among university students, to include high schools and workplaces. Another author suggests introducing an Erasmus programme for unemployed youth, who would spend time in another European country learning new skills and a new language, to improve their employability.

15. An Erasmus exchange programme for young professionals

"Many countries have introduced mandatory work experience for high school students, usually lasting between one week and one month. A programme should be created to encourage students to do their work experience in another European country, as opposed to their own, in order for them to embrace the idea of an integrated workplace. The same could be done at the apprenticeship level, with short-term exchanges of apprentices among companies operating in the same sector."

– *Innovation, investment and integration,* **Pietro Marone and Nicola Santospirito,** United Kingdom

Product market reform

For all the focus on labour market reforms, several authors are blunt about the political sensitivities of making these changes, which can be a difficult sell to national parliaments and the public. One way around this is to focus on politically "easier" structural reforms; one essayist recommends focusing on product market reforms, which tend to be less problematic, including acceptance of car-sharing services or loosening restrictions on pharmacies, which are heavily regulated in a number of EU member states.

Proposals for a smooth integration of migrants into the labour market

Pro-growth immigration was one of the 11 growth drivers we detailed in the MGI report, for a Europe whose working-age population is shrinking. This theme was picked up and elaborated on by several authors in the context of the labour market and the political acceptability of immigration, which has become a highly controversial topic in the past 18 months as millions of refugees from Syria and elsewhere in the region have sought to gain entry into Europe.

Those essayists who discuss the issue of immigration overwhelmingly favour it as a way to boost economic activity in the long term in the face of declining demographics, and propose ways to organise migration in a way that corresponds with the economy's needs and thus helps calm the controversies. Some propose adopting point systems similar to those used in Australia or New Zealand.

Two of the more innovative essays on this subject go further. The first suggests the adoption of a "unified worker skill scale" to identify immigrants with the highest potential of qualifying for work in the European Union. This score would be based on a migrant worker's level of education, their language and other basic skills, industry-specific vocational or technical training, and industry-specific prior experience. It would also take into account weighted city-wide worker rankings, so that both employers and migrants would be able to see the average skill-level present within a community, and whether the needs of employers for such skills are already covered by the available workforce. The second essay suggests the creation of a novel financial instrument, a "reversible bond," funded by employers willing to hire foreign labour, and used to give financial incentives to hire natives when possible, and compensate for adverse consequences such as job displacement, brain drain, or deportations of immigrants that turn criminal. The author argues that common political objections to migrants include that they take jobs from natives, that they may impose a fiscal burden on the welfare state, and that they lead to brain drain in sending states.

16. "Reversible bonds" – A new financial instrument to manage immigration

"The core idea behind the Reversible Bond is to pool the funds that are used to insure the destination countries against labour displacement or fiscally induced migration and the source countries against the costly brain drain. Ultimately, the funds are disbursed to the party whose concerns will have materialised after information about the migrant's "success," and the ultimate decision to stay or to return has been gained. Consider an imaginary German hospital that is not able to recruit an adequate number of qualified nurses—a scenario that is very real today and only expected to get worse as German society ages. A recent study by Bertelsmann Foundation indicates that 61 percent of German nursing care firms have gaps in filling their positions already today. However, they rarely hire from abroad, citing bureaucratic and legal problems, including difficulties in obtaining immigration permits. At the same time, many developing countries, including the Philippines, educate a great number of nursing professionals. One of them, imagine, is "Mariel" who is keen to move to Germany to work in a hospital Heidelberg that is desperately looking to fill its vacancies.

Now, this is how the reversible bond would facilitate Mariel's immigration. As a condition for entry, the Heidelberg hospital deposits a bond—say €50,000 for the purpose of this discussion—into a Migration Fund. This fund could be managed by a private company, which would have a contract with the destination country government, the source country government, and the migrant's sponsor i.e., the hospital. The bond would serve multiple purposes. First, the requirement to post a bond alleviates the concern that the employer substitutes available domestic labour with foreign workers. If the hospital had access to numerous German (or other European) nurses whose recruitment would not require a €50,000 bond, it would not hire Mariel. The decision to sponsor Mariel's entry hence sends a credible signal that the labour market needs are real. But the bond also responds to a number of other concerns that are likely to materialize later. After a certain predetermined period—for instance, at the time Mariel becomes eligible for citizenship in Germany—a determination would be made about the disbursement of the bond. The funds would be disbursed differently depending on the outcome with respect to two variables: first, whether Mariel has been "successful" or 'unsuccessful" in Germany and, second, whether Mariel remains in Germany or returns to the Philippines. Mariel is considered successful if she remains employed or otherwise capable of supporting herself in Germany. She is considered unsuccessful if she becomes unemployed and needs to rely on welfare benefits to support herself. Naturally, if Mariel engages in criminal activity or otherwise meets conditions for deportation, she would be considered 'unsuccessful'."

– *Implementing a pro-growth immigration strategy to revitalize the European labour market,* **Anu Bradford,** United States

CREATING A REFORM DYNAMIC

Good ideas are valuable in themselves, but our specific objective with this essay contest has been to elicit not just responses to the question of "what" needs to be done, but specifically to prompt ideas about "how" to do it. Implementation is key—and tricky. As many of our essayists point out "reform fatigue" is widespread among the public in EU member countries, and opposition to structural reforms in particular can be tenacious. Jean-Claude Juncker, current President of the European Commission, articulated the dilemma for government leaders already back in 2007, when he was Prime Minister of Luxembourg. "We all know what to do, but we don't know how to get re-elected once we have done it," he said at the time.[9] The best submissions to the MGI prize contest devote an important share of their essays to the question of implementation.

Adopting best practice reform implementation

Paying heed to best practices elsewhere is one common recommendation. One of the most detailed essays in this vein used the example of Sweden as a country that has undergone a radical turnaround in its economic model over the past 30 years, moving from a heavily regulated country with a large welfare state financed through high tax rates, to a champion of trade openness, deregulation, privatisation, and competition, while maintaining the fabric of its social system. Sweden's GDP growth rates of almost 4 percent annually and its dynamic employment also stand out in a Europe whose growth overall has turned sluggish. The author focuses on how Sweden had managed this transformation, putting up five guidelines that could be used to enact successful reforms in the EU more broadly. They include the key importance of democratic legitimacy and political support for reforms, even if that takes time to muster, with strong alignment on overarching objectives of an EU reform plan; a strategic roadmap; and clear sequencing of reforms to address obstacles. They further include a number of principles on methods, e.g. the notion that reforms at a country level should be made based on that country's own interest, cross-party support with social partners in the lead of drafting reform content, private-sector involvement to unlock private and focus public resources, and a high level of transparency at all stages and levels to maintain trust of citizens, including use of digital tools to achieve it.

Developing a new narrative, and new mechanisms, for Europe

The idea of stronger democratic legitimacy also features in a number of other essays. Some authors engage in thought experiments about how to improve the structure of decision-making within the EU so that ordinary citizens, and national parliaments, increase control and oversight. One such essay argues that the EU needs to re-establish itself as a body that is trusted and seen as capable of producing positive change. The founding narrative of 'peace in Europe' has lost traction over the years, the author argues. It is therefore crucial to develop a new raison d'être for the European Union that must be rooted in reviving the promise of progress and prosperity in times that are characterized by insecurity and uncertainty. To that end, he proposes what he terms "integrated subsidiarity."

17. Restoring trust in European institutions through "integrated subsidiarity"

"In a system of what might be called 'integrated subsidiarity' a European growth agenda would be initiated at the European level with a general framework and some specific features. National parliaments would then debate and positively reinforce the overall agenda with discretion over steps that reflect national realities and provide different routes of implementation. They in effect translate the jointly agreed European agenda positively into their national contexts. Integrated subsidiarity in essence is not concerned with delineating boundaries between the competences of different governance levels but actively working on connecting them whilst keeping the core principle intact. There are of course already ways in which the European, national, and local levels of governance cooperate but there is no fully coherent framework within which the highest priority projects can be consistently enshrined into multi-level agendas that open all levels of governance up to wider participation."

– *Reviving the promise of prosperity in the European Union,* **Henning Meyer,** United Kingdom

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9 "The quest for prosperity," *The Economist,* March 15 2007.

European policy makers should do more experimentation, accompanied by rigorous testing and evaluation of their policies, before launching large-scale implementation, several essayists argue. One proposes creating a European policy testing mechanism, under which EU countries would try out a set of policies in a small test region or country, a "special innovation zone." If certain predefined results are met, the zone would expand to include one of the larger EU countries, such as France or Germany. If predefined results are obtained there, then the policy is rolled out across the EU.

Our under-30s prize winner, Antoine Levy, focuses most of his essay on implementation issues. Reforms will have to "recreate a sense of belonging," he argues. Rather than uniform policy programmes applied throughout Europe, the focus should be on promoting best practices. EU institutions should become policy "fablabs" willing to experiment new measures. They could include Europe-wide contests for the innovative provision of public services that would be financed by European Social Impact Bonds, and European "competence clubs" that would group cities, regions, or nations based on common interests, rather than obliging all member states to participate. Reform proposals would be subject to independent evaluation of results as a way to ensure that unsuccessful reforms would be phased out. Laws and rules would routinely contain "sunset clauses" to ensure they would be reviewed, revised and potentially phased out, rather than taking their place permanently on the statute books.

Compensating losers

Mr Levy also proposes "paying to reform", including mechanisms such as compensating losers for instance via GDP-indexed shares to workers affected by foreign competition for trade deals, or offering opt-out mechanisms. They could include auctioning off the right to remain in life-long civil service status or allowing people to opt out of increased retirement ages against pre-determined cost to their pensions. Another proposal is to grandfather rights for the status quo during transition periods by introducing a unique cross-country labour contract only for new contracts while allowing everyone else to stay in current contracts.

18. Adaptable, acceptable, and accountable: guiding principles for reform

"Europe's lack of economic dynamism and mobility, the so-called *Eurosclerosis*, is not a fatality. Barriers to entry and exit for workers, firms, innovators, and investors reduce the continent's ability to transition to a modern knowledge economy, and create powerful vested interests resisting change. However, there exists a potential coalition ready to challenge the status quo ante, on the condition that they feel empowered in the design of reform through appropriate governance structures; that they be fairly represented in the distribution of their benefits; and that they be granted democratic control over their implementation.

To answer this triple-D social demand, a triple-A rating for the supply of reform processes is needed. The three guiding principles should answer the need for adaptability of the design, acceptability of the distribution, and accountability of the democratic control. This translates into very concrete and specific policy proposals, including, but not limited to: the use of European Social Impact Bonds to finance innovative provision of collective services; the compensation of losers from reforms by growth-indexed entitlements to better align incentives; the use of "opting-out" clauses for entitlement reforms, and of "grandfathering rights" to deal with transition periods; the design of "European competence clubs" of countries willing to step up integration on specific policy topics; or the recognition of relevant local scales of democratic legitimacy, including some overlapping existing jurisdictions."

– *Reforming Europe by the people, for the people.* **Antoine Levy,** France/United States **PRIZEWINNER**
(Mr Levy's full essay is reprinted later in this booklet)

Communication: Strengthening a European identity

Among the "light" approaches, one essay proposes five small-scale initiatives each of which is designed to have a quick impact in terms of the image and effectiveness of the European Union. They include creating a political drama akin to the US hit TV series "House of Cards," set in present-day Europe, and featuring the lives of a recently-elected European Prime Minister, and a top Commission speechwriter. The purpose: "to showcase Europe and mentally link it to entertainment."

Another proposal is to build or strengthen a European identity with public debate and newspapers, or even institutions like a common army or police. One author proposes EU parliament factions to campaign as a united front rather than via national parties.

Engaging citizens: Consultation, transparency, and accountability

The question of how European institutions can reconnect with the public is raised by many of our essayists. Greater use of public consultation over measures is a recurring theme, the idea being that more consultation will ensure a higher degree of public acceptance. One essay proposes the "largest public consultation in EU history," a one-year or more "engagement for growth" discussion with a broad range of stakeholders on existing and future growth and development programmes. This would support a future political narrative that gives the EU a convincing "why", and positions it as a "social empire" that empowers people.

19. A European engagement for growth : "Make it relevant and they will come"

"We propose the largest public consultation in the EU's history, the European Engagement for Growth. It would build upon the traditions set by the Lisbon and Europe 2020 growth strategies but endeavour to include more citizen driven policy-making. Unlike the series of public consultations normally informing European Commission initiatives and programmes, this engagement would go beyond mere opinion stock-taking and would instead focus on participation from all European stakeholders and foster institutional trust. While current consultations usually last three to four months, we would want to establish meaningful partnerships and dialogues that lead to actionable steps over a longer period of time. Practically, we envision the EEG to starting as a one-year consultation addressing growth drivers in Europe. Discussions would have a heavier emphasis on the local level, encouraging national actors to host conferences, workshops, online surveys, and utilise existing partnerships with a wide range of stakeholders. The inclusion of a diverse range of voices is paramount to Europe's success. It has been shown that organisations that embrace diversity are achieving better results. Current consultations are conducted with a 'build it and they will come' strategy and it is not effective. We believe in a 'make it relevant and they will come' approach. It would be done in two ways: First, the EEG would emphasize policy stock-taking and highlight best practices and underutilised opportunities. Existing frameworks would be discussed; where European programmes have been successful they should be deepened, likewise ineffective initiatives should be phased out. Course adjustments need to be accepted if Europe wants dynamic growth. This consultation provides an open space for citizen and stakeholder driven policies and initiatives. Second, the EEG would inform the development of the next European growth and development strategy set for the duration of the 2020s as well as help member states coordinate their own action plans. With the public review of the Europe 2020 strategy in 2014, it became clear that the framework had low visibility, with room for improvement in terms of implementation on local levels. It also showed that stakeholders are willing to become active participants in such strategies. By creating a development plan with the help of a Europe-wide consultation, it sets the stage for targets that people can buy into and there is a clear understanding of the level of support that stakeholders need in order to succeed."

– *The European engagement for growth,* **Alexander Lars Eino Mäkelä,** Sweden, and **Bethany Esther Thornton,** United Kingdom

In a similar vein, another submission advocates citizens donating money to a fund and then voting on projects in Europe they deem worthy of receiving grant money from the fund – as a way to create citizen accountability, European spirit, and a common European budget or fund temporarily until treaty changes allow completion of the currency union with full democratic legitimacy and fiscal capacity. People would contribute to a "Europeans for Europe" Recovery Fund, the author suggests, because they would be rewarded with some personal advantage, because they would enjoy some kind of ownership in the process—and because this would make them feel really European, "taking up responsibility for their destiny." Citizens who donate at least 1,000 euros to the fund would receive a full tax deduction on their contribution, along with a card that allows them to benefit from 10 percent reductions on the price of goods and services of companies financed through the fund.

20. A "Europeans for Europe" investment fund

"Together with ownership, assuming responsibility for the recovery of the continent would strengthen European identity, shorten the distance between citizens and institutions, and increase a sense of solidarity. To this end, the process has to be fully denationalised: the money, wherever it comes from, will be invested in initiatives anywhere in Europe, according to the principle of unity of the budget."

– *"Europeans for Europe": Recovery in the age of interdependence,* **Susanna Cafaro,** Italy

National governments and European institutions also owe it to the public to be more transparent about how they operate, what their objectives are, and how well they meet them, several essayists suggest. Government departments across Europe should submit annualised performance indicators together with their budgets, and these indicators would be audited and form the basis for subsequent budget negotiations—and for performance reviews of civil servants.

• • •

What lessons can we—and Europe—draw from these ideas? The first is a positive one: that many people around the world have ideas and opinions about what is wrong and what needs to be fixed. Not all these ideas are original, and the quality of the essays we received varied quite widely. Yet the energy and the aspiration for a better, stronger, and more dynamic Europe are there; we have 401 tangible pieces of evidence of that. The second lesson is that change and reform are possible. Not all the ideas articulated are politically easy or institutionally feasible—but many are. Some propose measures that cost little but could have a big impact, if executed well. Other proposals that have a more institutional nature, whether it be relaunching the Capital Markets Union to encompass climate change and responsible investing, or devising a pan-European "cluster strategy," are weightier and more complex, but not unthinkable and the obstacles to achieving them are not insurmountable. The third lesson is one that resonated with numerous authors: the idea that while a return of stronger economic growth is vital for Europe's future, it is not a cure-all. More is needed. As Antoine Levy, our under-30 prize winner puts it: "Political enthusiasm and trust in national and regional institutions will not be rekindled by achieving a few additional basis points of GDP growth; nor will a brighter outlook on future economic perspectives for the many stem from a visionless, technocratic reform masterplan, imposed from the top without concerns for design, distribution, and democracy." We tend to agree. Europe will shine again if engaged citizens take ownership of their continent. Having so many of them contribute such stimulating and thought-provoking ideas to an essay contest is a first step in that direction.

PRIZE WINNERS

JOINT WINNERS OF THE 2016 MGI "OPPORTUNITY FOR EUROPE" ESSAY CONTEST

PROFESSOR VOLKER BRÜHL

Volker Brühl is the Managing Director of the Centre for Financial Studies at Goethe University in Frankfurt since 2013. Furthermore, he is a Professor for Banking and Finance. His current research interests focus on Financial Markets, Banking Regulation, Systemic Risk and Corporate Finance. Before returning to academia he has worked for many years as a Top Manager in Banking and as a Management Consultant, e.g. he has been a divisional board member of a large German bank and a managing director in an international Investment bank. Brühl serves on a variety of advisory boards of academic and non-academic institutions. He received a Ph.D in international finance and received the university award for his thesis.

DAN CIURIAK

Dan Ciuriak is Director and Principal, Ciuriak Consulting Inc. (Ottawa), Fellow in Residence with the C.D. Howe Institute (Toronto), Senior Fellow with the Centre for International Governance Innovation (Waterloo), and Associate with BKP Development Research & Consulting GmbH (Munich). He is active professionally in international trade, finance, industrial policy, and economic development. He has published widely as author and editor, within government and in a personal capacity; commented in the media; and spoken at many academic, business and official venues. He concluded a 31-year career with the federal public service in 2008 as Deputy Chief Economist at the Department of Foreign Affairs and International Trade (DFAIT). Prior positions include deputy to the Chair of the APEC Economic Committee (1994-1998), Finance Counsellor at Canada's Embassy in Germany (1990-1994), and Chief, Financial Institutions, and Project Director, Financial Institutions Reform with Canada's Finance Department (1982-1990).

AWARD FOR THE BEST ESSAY BY AN AUTHOR UNDER THE AGE OF 30

ANTOINE LEVY

Antoine Levy, a 23 year-old French national, is a PhD candidate in economics at MIT (Cambridge, MA), specialising in macroeconomics and international finance. He holds an MA in economics from the Ecole Normale Supérieure (Paris School of Economics) and a Master's degree from HEC Paris, after having been ranked first in the admission contests of both these elite French institutions. He had numerous experiences in economic research and teaching, notably at the European Bank for Reconstruction and Development, HEC Paris, Sciences Po Paris, and PSL University. He also worked for a year in the sovereign macroeconomic and debt advisory practice of a major investment bank, counselling governments on economic policies and debt management. He has written several op-eds and columns for major French newspapers, such as *Le Monde* or *L'Opinion* on current economic matters.

EUROPE!

PRIZE WINNER

Volker Brühl

Three Cornerstones of a European Growth Initiative “EU 2025” – National Growth and Investment Programs (NGIP), a European Cluster Strategy and a modified “Fiscal Compact”

1. Introduction

The European Union (EU-28) as well as the Eurozone (EU-19) in particular is facing significant economic challenges since the Financial Crisis 2008 and the Sovereign Debt Crisis starting with Greece in 2010. Nevertheless, the European Commission together with the member states have achieved fundamental reforms in a number of areas to stabilize the macroeconomic environment, reduce systemic financial risk and initiate further growth in Europe. Important measures include the reform of the Stability and Growth Pact ("SGP") including the "Fiscal Compact", the European Stability Mechanism (ESM) and the European Banking Union (EBU). Further achievements include substantial research initiatives like the Horizon 2020 programme and the European Fund for Strategic Investments (EFSI) launched in 2015.

All these measures are important and useful contributions both as stabilizing elements in the crisis and as enabling instruments for future growth in the European economy. The Quantitative Easing Policy (QE) of the ECB is supposed to ease corporate financing across Europe and to help avoiding deflation and stagnation in the Eurozone and beyond. Nevertheless, various research studies point out that Europe is below its own growth aspirations. To meet the challenges of an aging population, persistent high public debt levels and a heterogeneous economic structure Europe needs to embark on a new growth trajectory. In order to achieve this, structural reforms both on a national and European level need to speed up as a recent study of the McKinsey Global Institute explained.[1]

This paper suggests a new European growth initiative "EU 2025", that combines "National Growth and Investment Programs (NGIP)" with a European Cluster Strategy and a "new fiscal deal". The latter aims to unlock more financial resources for public investments by introducing some modifications but without violating the basic concept of the Stability and Growth Pact.

In the next chapter a brief summary of the economic status quo is given to set the framework for the following analysis. In chapters 3 and 4 the idea of "National Growth and Investment Programs (NGIP)" in combination with a European Cluster Strategy is presented in more detail. A particular focus is put on a modified "Fiscal Compact" in chapter 5 that proposes a differentiated treatment of government spending depending on whether the public expenditures are made for investment purposes or for government consumption. Such a concept would lead to revised calculations of budget deficits and public debt levels and thus would generate additional headroom for public investment activities without abandoning the fiscal consolidations process in Europe.

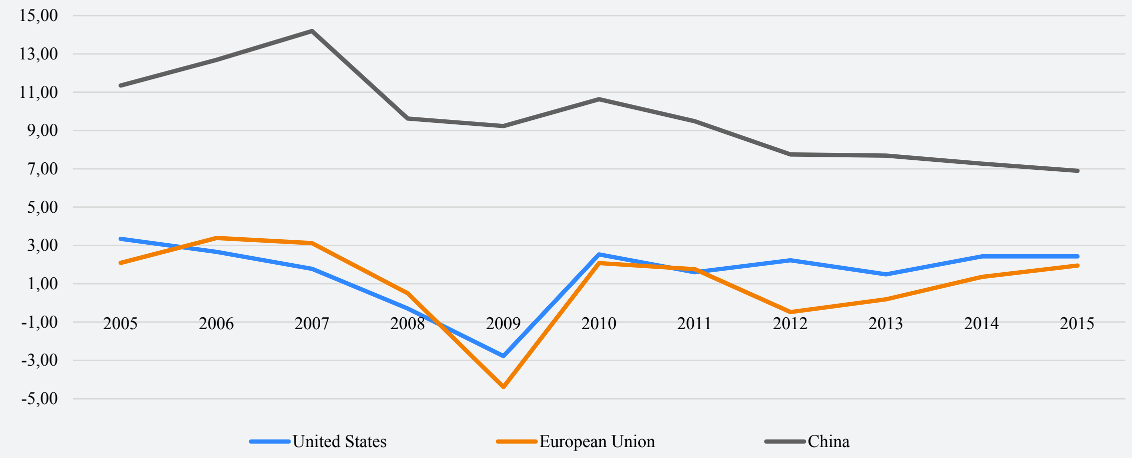
[1] See McKinsey Global Institute (2015).

2. The economic status quo in the EU28 – a brief overview

GDP growth rates in Europe have been persistently below the US for several years (Figure 1).

FIGURE 1

Real GDP growth rate 2005 – 2015 (percent)

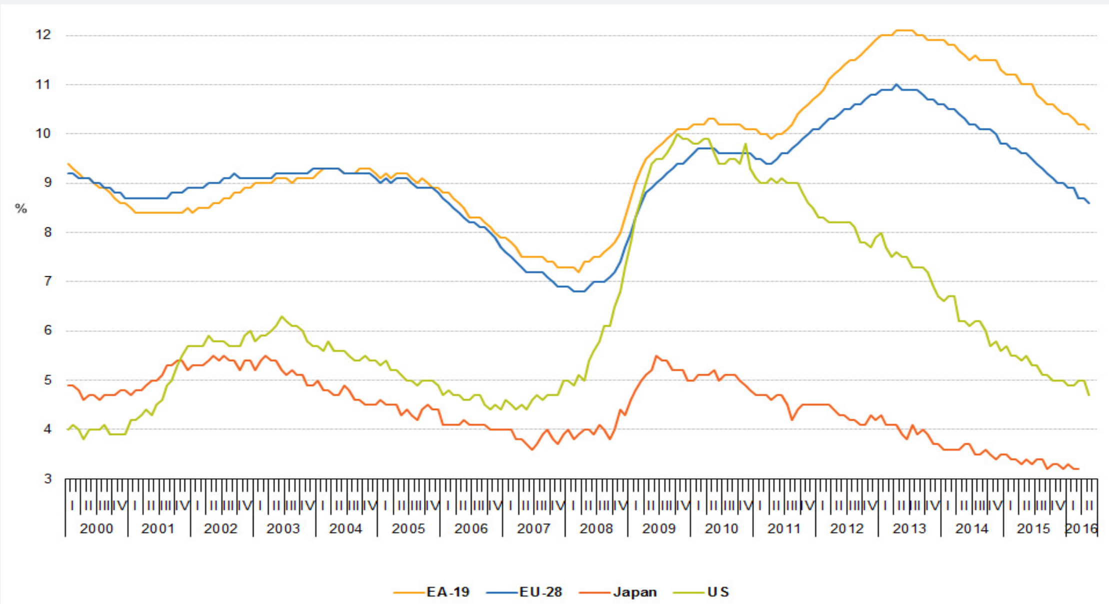


Source: World Bank, own analysis

This development is also reflected by higher unemployment rates both in the EU-28 and in the Eurozone. Figure 2 shows that improvements of the US labour market have appeared earlier and faster through the cycle than in Europe. The reasons for the underperformance of the European economy are manifold. But the implosion of public and private investment activities in many EU member states since the global financial crisis is widely regarded as an important factor.

FIGURE 2

Unemployment rates 2000 – Q2/2016 (percent)



Source: Eurostat

The investment gap in the EU

The EU has been suffering from low levels of investment since 2008. Compared to the 2007 peak, investments have dropped by around 15 percent in the EU. If one assumes that investments account on average for 25 percent of GDP, EU investment activity has been substantially below this level since the financial crisis. In 2014 the EU investment gap is estimated to be between €240 and 380 billion; over the whole 2009 – 2014 period, the cumulative investment shortfall exceeds €1,200 billion.[2] Largest drops occurred in Greece (-65 percent), Cyprus (-61 percent) and Romania (-53 percent) compared to the pre-crisis level.

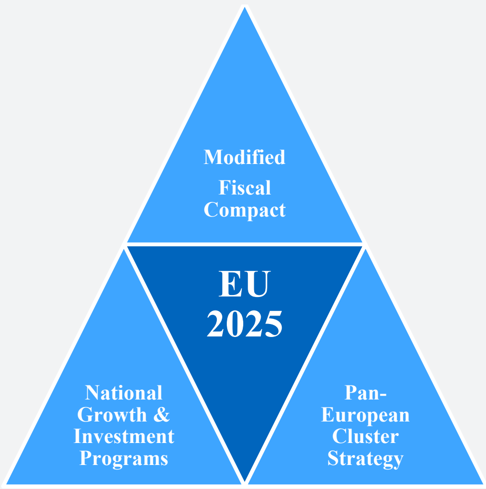
As capital investments are an important driver of economic growth and employment, the EU Commission has put a lot of effort on closing the investment gap by reshaping the regional investment policy. Investment Policy is delivered through three main funds: the European Regional Development Fund (ERDF), the Cohesion Fund (CF) and the European Social Fund (ESF). Approximately €351.8 billion has been designated for Cohesion Policy for 2014-2020.[3] In addition the European Fund for Strategic Investments (EFSI) has been established in 2015 to help regaining confidence of private investors. But recent data and forecasts suggest that even more effort and new stimuli are needed to allow the EU to get back on a sustainable growth path.

3. The idea of a European growth initiative "EU 2025" – three pillars

The proposal outlined in this paper consists of three pillars (Figure 3). The first one suggests that each country develops its own strategic growth agenda ("National Growth & Investment Program," NGIP) based on its existing resources, skills, capital and innovation potential. The design of such an economic policy programme should aim to leverage competitive strengths and comparative advantages of the country in the best possible manner by aligning them with key success factors of the respective industry. Such a NGIP may include a broad range of measures including structural reforms, deregulation, privatization, flexibilisation of the labour market and public investments in critical infrastructure.

FIGURE 3

Elements of a growth initiative "EU 2025"



Source: Own concept

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[2] See European Commission (2015a).

[3] See European Commission (2015b).

NGIPs should be discussed with the EU Commission and be complemented by a pan-European Cluster strategy. The importance of clusters – defined as agglomerations of interconnected businesses – as drivers and catalysts for economic development has been confirmed by empirical research. However, most cluster initiatives are currently being undertaken on a national level. Although the EU Commission already pursues cluster initiatives within its cohesion policy, a much stronger focus on a cluster policy backed by substantially higher financial investments is necessary to ensure global competitiveness of Europe particularly in emerging high growth industries.

The third pillar is a modified "Fiscal Compact" which allows the commitment of additional financial resources for public investments both on a national and a European level to regain trust by private investors and to break through the underinvestment climate.

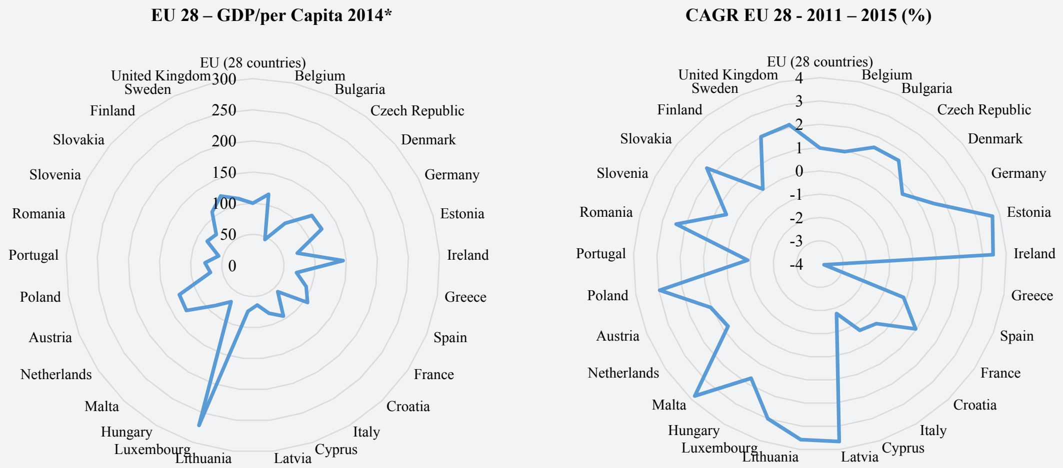
4. National Growth and Investment Programs (NGIP) in combination with a European Cluster Strategy

The starting point to set up a European programme for growth and development is given by the existing regional and sectoral economic structures as they provide the fundament for national growth and investment programmes.

4.1 The economic anatomy of Europe

The economic structure of Europe is very heterogeneous both in terms of productivity and growth rates, which is shown in Figures 4a and 4b.

FIGURES 4A AND 4B



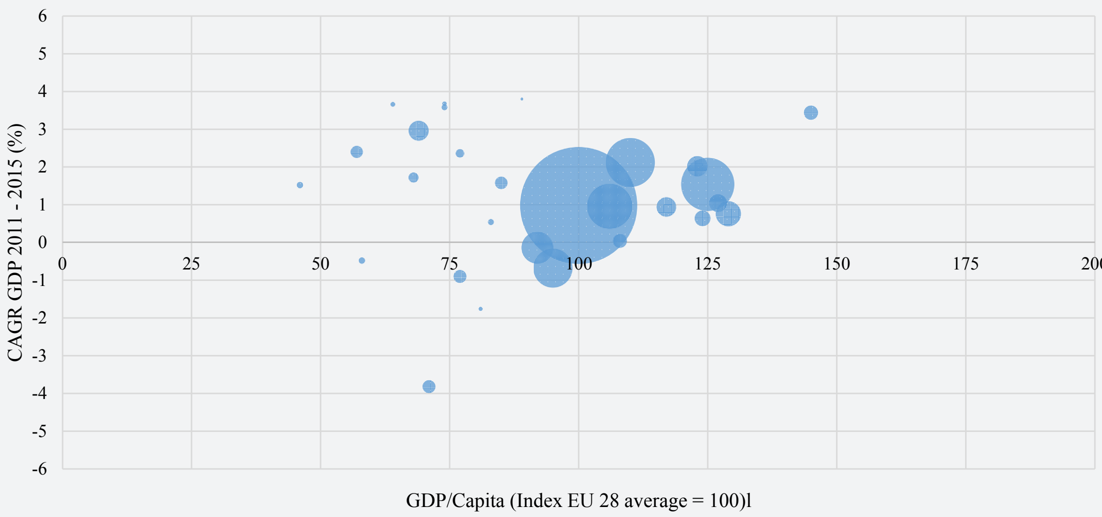
* indexed figures with EU 28 average = 100

Source: Own analysis based on Eurostat data

The combined growth- and productivity perspective (Figure 5) reveals that high productivity rates not necessarily imply above average economic growth rates and vice versa. There are a number of European countries like Bulgaria, Romania, Czech Republic or Slovakia who experience growth rates of more than 3 percent p.a. although their productivity is around 20 percent to 25 percent below the EU-28 average. Reasons for this include corresponding low wages, a relative limited overall size of the economy (basis effect) but also a focus on sectors that are less capital- and know-how-intensive.

FIGURE 5

Productivity-Growth Portfolio EU28



Source: Own analysis based on Eurostat data

Figures 6a and 6b show the regional distribution of agricultural and construction activities as well as the respective figures of the industrial and service sectors. Agricultural activities in a broader sense constitute an important part of the GDP in the so called "GIIPS" states (Greece, Italy, Ireland, Portugal and Spain) but also in some Eastern European countries. The respective regions benefit e.g. from comparative advantages in terms of climate conditions and cost advantages due to lower wages. Regarding the contribution of the construction sector to country GDP. Figure 6a underpins that also in some regions of the GIIPs countries construction activities are below EU-28 average although a prospering construction sector is an important enabler for growth in industrial and service sectors, especially if it leads to building and modernizing logistical infrastructures.

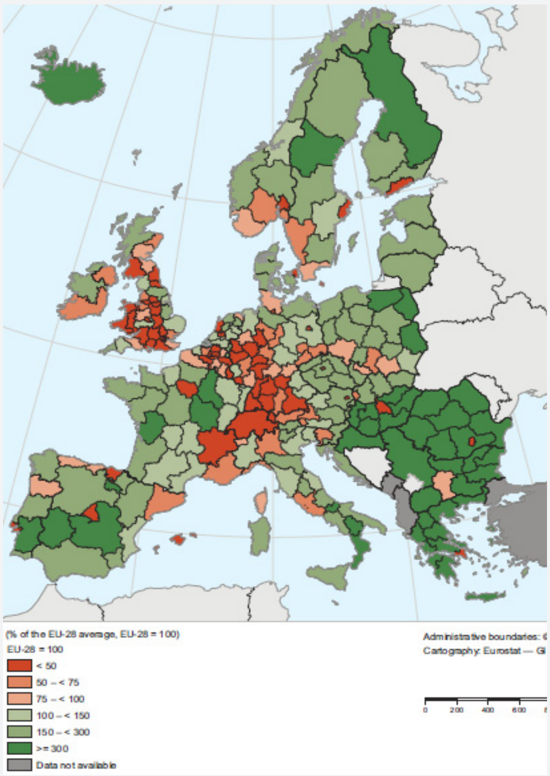
Strict budget restrictions due to high levels of public debt may prevent essential investments into basic infrastructure. This is obviously the case in GIIPs countries but this also applies to countries like Bulgaria and Romania that apparently need much higher investments into infrastructure to bring these countries to the next level and make them more attractive for Foreign Direct Investments (FDIs). A modified "Fiscal Compact" could provide more leeway for such measure

Furthermore, Figure 6b demonstrates that there are only a few regions in EU-28 that could be described as industrial centers. Conversely, there are big parts of the EU-28 that lack manufacturing activities. The picture is even clearer regarding the level of service activities across the EU-28. More than 80 percent of the economic regions in Europe suffer from a below average service intensity. As the service sector is viewed as a major growth engine for developed economies, this is also an important observation point when it comes to bringing Europe to the next growth trajectory.

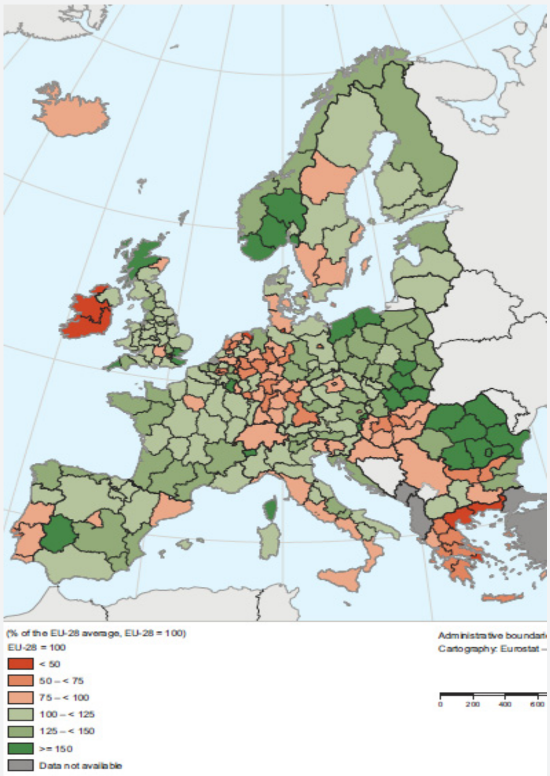
FIGURES 6A AND 6B

Regional economic structure EU-28

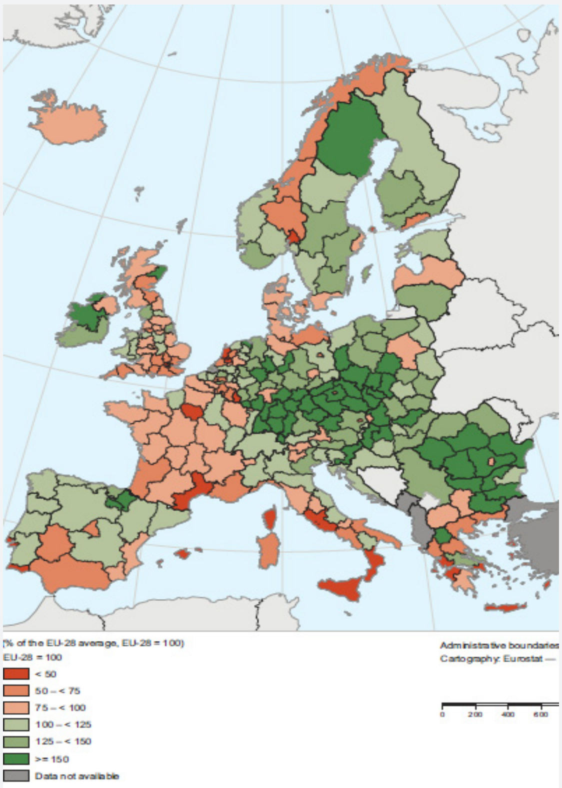
Agricultural activities



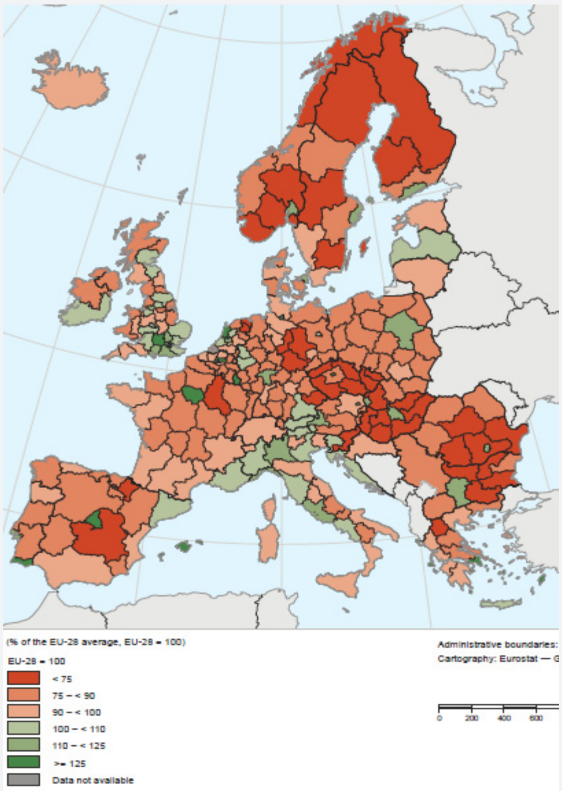
Construction activities



Industrial activities



Service activities



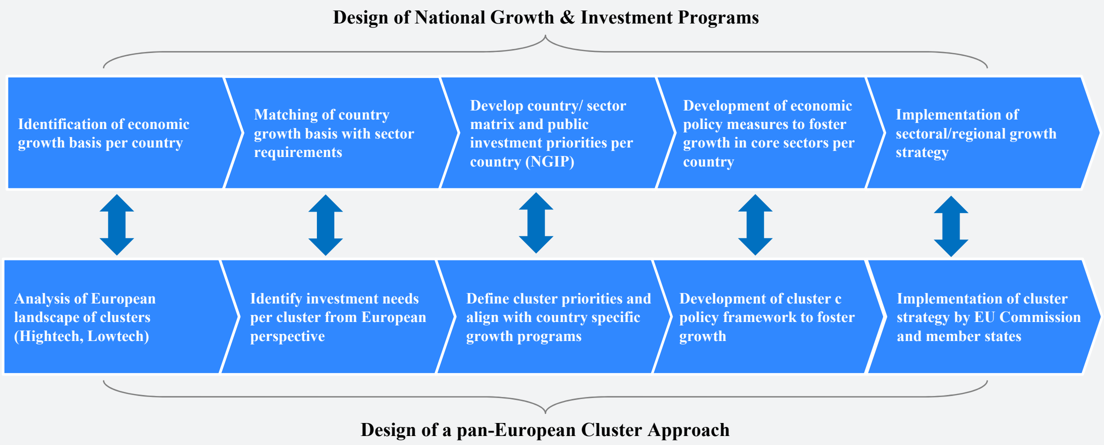
Source: Eurostat

4.2 The strategy process for "EU 2025" – NGIP and Cluster Strategy

My proposal suggests that each country prepares a "National Growth & Investment Plan (NGIP) while the EU Commission focuses on creating a pan-European cluster strategy. Both dimensions go hand in hand and need to be coordinated accordingly. Figure 7 summarizes the key steps of a strategy process "EU 2025".

FIGURE 7

Alignment of NGIP and European Cluster Strategy



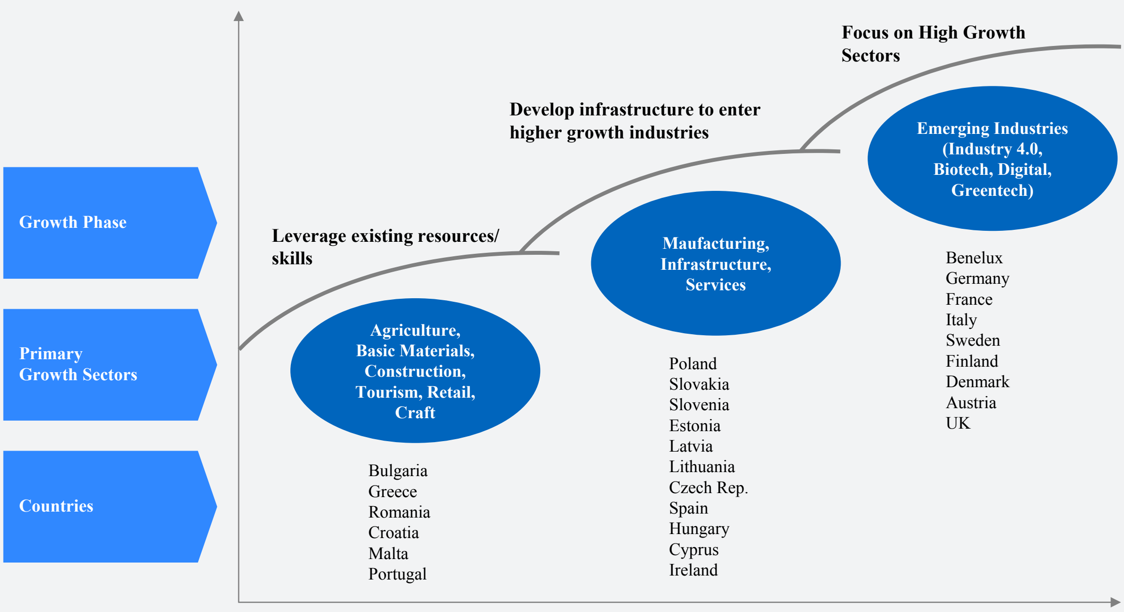
Source: Own concept

4.3 National Growth and Investment Programs (NGIP)

The formulation of country-specific NGIP depends on various factors like e.g. the state of economic development, the endowment with production factors or the quality of infrastructure in the respective country (Figure 8).

FIGURE 8

Growth strategies and state of economic development



Source: Own conceptual illustration

In Figure 8 European countries are divided in three groups according to their state of economic development and therefore the key growth drivers they could potentially activate. This allocation of member states is preliminary and exemplary.

Countries of the first group usually suffer from a lack of infrastructure, state of the art educational and health care systems, a highly skilled workforce and a low level of capital inflows. Hence economic growth is fueled by existing resources, capabilities and skills. Accordingly important areas of growth are agriculture and basic materials. Besides parts of the service sector like e.g. transportation, tourism, crafts and retail are major employers. Figure 8 lists a number of emerging economies in EU-28 that could fall into this category.

It is important to keep a realistic view on what these countries can realistically achieve in the short and medium term before they may jump to the next level. Several southern and eastern European countries are prevented from fully exploiting their potential in agriculture, basic materials or energy as subsidies or other protective measures in major European economies preserve non-competitive industry segments. The consequences of such misincentives are obvious e.g. in agriculture or the renewable energy sector.

For countries in the second group comprehensive growth programmes and bold investments into the infrastructure for logistics, telecommunications and modern government architecture are necessary to attract foreign investors and enable countries to increase the proportion of manufacturing and service businesses of the GDP. These countries often don´t have the financial resources to conduct these investments on their own. A modified "Fiscal Compact" would allow a significant increase in the volume of the European investment programme in critical infrastructures. The successful establishment of automotive supply clusters or the development of logistical hubs in some eastern European countries are encouraging examples. Important ingredients for such a development are low barriers to foreign investments provided by fast administrative decisions, flexible labour markets and a modern infrastructure. Structural measures may also include transferring best practice experience from education and training systems into other countries. Dual training as is common in German speaking countries could be helpful to reduce unemployment rates in the younger population especially in southern European countries.

Finally, the group of mature European economies has to position themselves in high growth markets like Digital Business, Industry 4.0, Biotech, Greentech and Services. To succeed in such emerging industries a world class infrastructure, a highly skilled work force, dedicated research programmes as well as a number of market leading firms that operate in these fields are important ingredients to create new or promote existing clusters. Furthermore, an entrepreneurial culture for startups and a sufficient supply of venture capital are important as well.

The European economy is currently characterised by a large number of smaller clusters. A pan-European cluster strategy could help to "connect the dots" of clusters across national boundaries to achieve critical mass, avoid double investments and contribute to a higher innovation rate.

It should be emphasized that the support of high-tech industries should not be limited to those countries that are already well positioned as this could aggravate economic disparities in Europe in the long run. Instead the aspiration should be that each member state of the EU-28 is part of one or more of these cluster initiatives.

Referring to Figure 7 NGIPs are developed in five steps. Firstly the economic growth base for each country needs to be identified as it is crucial to tailor investment incentives to the respective profile of each country. Then country profiles are to be matched with key success factors and requirements of the various industries. Primary objective of this strategic analysis is to find out appropriate sectors that fit country specific resource profiles in the best possible way.

Then tailor-made policy measures including investment needs are developed that help to unlock inherent growth potential. These measures may cover a wide range of instruments and depend very much on the state of the economic development and structural conditions in the respective country. Some structural reforms may only be achievable on a European level or may require EU funding. It is essential to combine both the geographic and the industry dimension to achieve a consistent country-specific growth strategy. Finally a consequent implementation of the NGIP is vital and might be subject to a regular monitoring process by the EU Commission.

4.3.1 Key requirements per sector

In order to implement country specific growth strategies, a careful analysis of sector specific success factors needs to be performed. A preliminary segmentation of sectors and growth factors has been made in Figure 9. It should be noted that this is for illustration purposes only and by no means exhaustive. Further research is needed to achieve a common understanding for such an analytical framework.

Each economic sector can only successfully be established in a given country, if certain requirements in terms of resources, technological skills and innovations capabilities are fulfilled. Which factors are relevant depend on the nature of the industry and may include climate conditions (e.g. for agricultural products or tourism), natural resources (e.g. for mining or basic materials), logistical infrastructure (e.g. for transportation services), availability of highly qualified people (e.g. for high-tech) as well as a certain level of purchasing power (e.g. for retail). Some of the parameters that could foster growth are linked to the geography, others to the state of development, the educational system or to the agglomeration of existing enterprises that build already clusters.

The proposal outlined in this paper suggests looking at the following factors to design a growth profile for each country:

Resource Base

- Cost of Labour
- Availability of qualified personnel
- Climate Conditions
- Natural resources
- Logistical infrastructure
- Digital infrastructure
- Cost of Energy
- Availability of Capital

Technological Capacity

- Mechanical Engineering
- Electrical Engineering
- Process Engineering
- Assembly Engineering

Innovation Capabilities

- Digital Business
- Industry 4.0
- Biotech
- Greentech

The matrix in Figure 9 shows for a number of important sectors the relative importance of location factors for investors. The more the circles are filled out, the more important the respective factor is considered to be for establishing value added activities in the particular sector. Hence the matrix shows for each sector a profile that needs to be matched by the available resources, technological capacities and innovation capabilities of a country to attract regional operations and investments in that field.

FIGURE 9

Key requirements per sector – exemplary

	Resource Base								Technological Capacity				Innovation Capabilities			
Sectors	Cost of Labour	Skilled Work Force	Climate Conditons	Natural Resources	Logistical Infr.	Digital Infr.	Cost of Energy	Capital	Mechanical Eng.	Electrical Eng.	Process Eng.	Assembly	Digital	Industry 4.0	Biotech	Green Tech
Agriculture	●	○	●	○	◕	○	◔	◔	◑	◑	○	○	○	○	◑	◑
Basic materials	◔	◔	○	●	●	○	●	◕	◑	◑	◑	◑	○	○	○	○
Energy	◔	●	●	◕	●	●	◕	●	◑	●	●	◑	◕	◔	○	○
Automotive	◑	●	○	○	●	●	◑	●	●	●	◔	●	●	●	○	○
Aerospace	○	●	○	○	◕	●	◑	●	●	●	◑	●	●	◑	○	○
Capital Goods	○	●	○	○	◑	◕	◑	◕	●	●	◕	●	◕	●	○	○
Chemicals	○	●	○	◕	●	◕	●	●	◕	◕	●	◕	◑	◔	◕	◕
Construction	●	◔	◔	◑	●	◔	◑	●	◔	◔	○	○	○	○	○	○
Food Beverages	◑	◕	◕	○	◑	◔	◑	◑	◑	◑	◑	◑	◑	○	◑	○
Non Food	◑	◕	○	○	◕	◔	◑	◑	◑	◑	◑	◑	◑	○	○	○
Packaging	○	◕	○	○	◕	◑	◑	◑	◕	◕	◕	◕	◔	◕	○	○
Textile	●	◔	○	○	◑	◔	◔	○	◑	◑	○	○	○	○	○	○
Pharma	◑	●	○	○	◑	◑	◕	●	◑	◑	●	◑	●	○	●	○
Telco	○	●	○	○	◑	●	◕	●	○	●	○	○	●	○	○	○
IT (HW/SW)	◔	●	○	○	○	●	◔	◕	○	●	○	○	●	◑	○	○
Media	○	●	○	○	○	●	○	◑	○	○	○	○	◑	○	○	○
Financial Serv.	◑	●	○	○	●	●	○	●	○	○	○	○	◕	○	○	○
Tourism	◕	◑	●	○	●	◑	◔	◔	○	○	○	○	◑	○	○	○
Retail	◕	◔	◑	○	●	◑	◑	◔	○	○	○	○	◑	○	○	○
Craft	●	◕	○	○	◑	◔	◑	◔	○	○	○	○	○	○	○	○
Transportation	●	◔	○	○	●	◑	◑	◔	○	○	○	○	○	○	○	○

Source: Own illustration

4.3.2 Comparative resource profile per country

Therefore, a profile has to be set up for each country that allows a mapping between sector specific requirements and the respective country profile to identify potential growth areas. Country profiles are dynamic by nature and can be shaped by appropriate policy measures. Figure 10 illustrates a map with country specific economic profiles in terms of resource base, technological capacities and innovation capabilities. It should be noted that the relative strengths of a country in a given dimension is to be benchmarked against all other EU-28 member states. The Harvey balls in Figure 10 are exemplary and have to be backed by an analytical methodology that may include quantifiable KPIs or qualitative assessments. For instance the relative strengths regarding the innovation capabilities in a given field (e.g. Industry 4.0) could be measured by the number of patents or dedicated R&D expenses (both in absolute and relative terms) whereas data on other parameters like the cost of labour or the cost of energy are available.

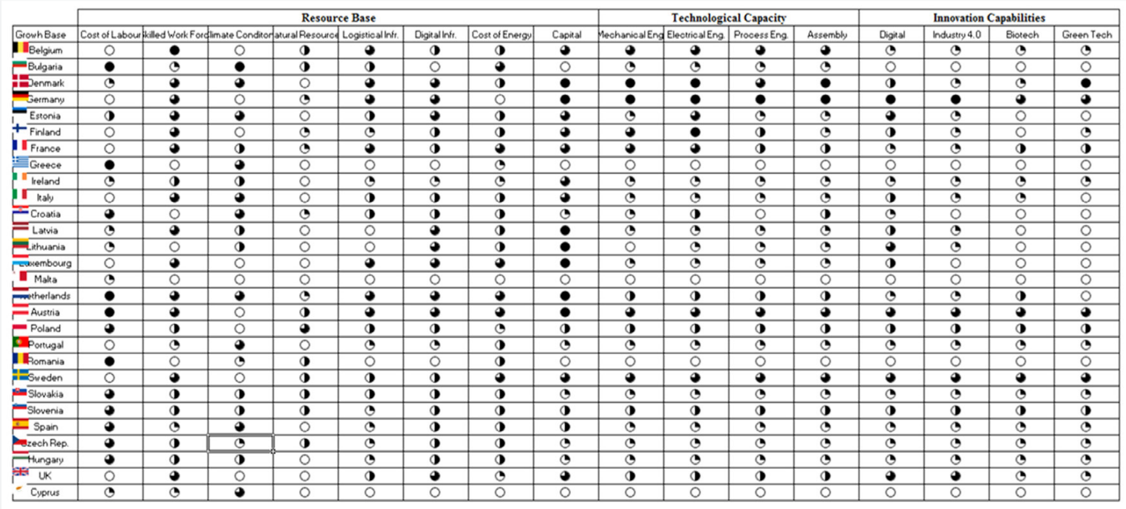
4.3.3 The “European Growth Matrix”

In order to generate a “European Growth Matrix” that displays the most promising areas for growth per country, a matching of individual country profiles (Figure 10) with specific sector requirements (Figure 9) needs to take place. Figure 11 shows how such a European Sector Matrix could look like for illustration purposes. It shows e.g. that most eastern European countries could substantially improve their position in the European logistics sector, if the infrastructure in these countries gets further modernized.

This in turn would need further government investments which could in some cases possibly not be financed without violating the criteria of the SGP. Therefore, additional funding from EU programmes or a modified “Fiscal Compact” would be necessary. Similarly the market shares in producing and trading agricultural products especially in the GIIPs countries appear to be below their potential due to structural obstacles preserving farming business on a minimum level in some countries despite a lack of economic viability.

FIGURE 10

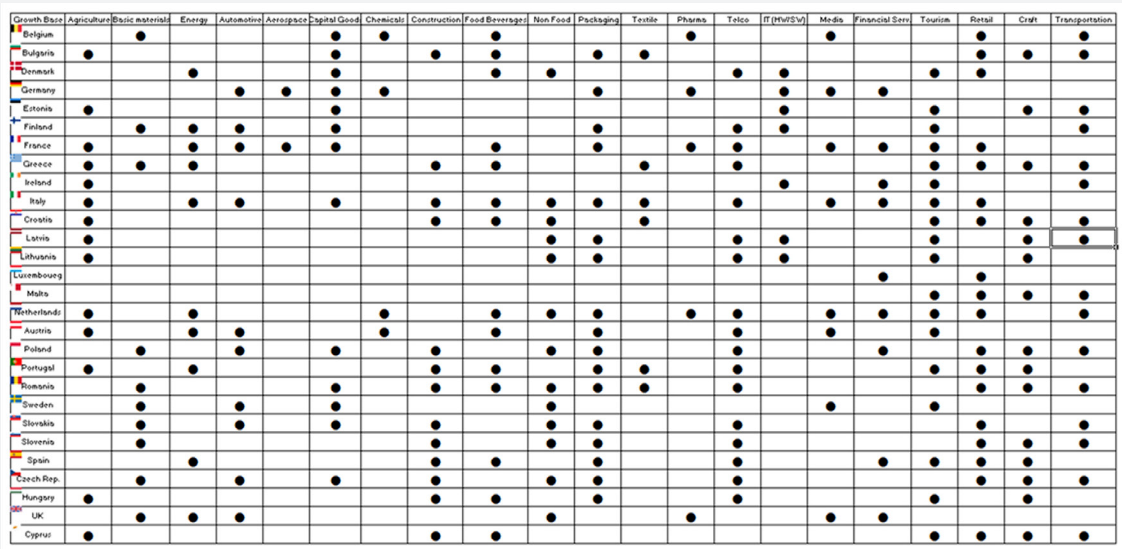
Competitive profile per country – exemplary



Source: Own illustration

FIGURE 11

Matching sectoral requirements with country-specific profile – exemplary



Source: Own illustration

4.4 A European Cluster Strategy

The second dimension of a growth initiative “EU 2025” alongside the NGIPs is a pan-European cluster strategy that can contribute to accelerating growth in Europe by promoting clusters across countries. Clusters can arise for different reasons, e.g. they may be a consequence of a regional concentration of e.g. natural resources, talent, skills or tradition. Furthermore clusters can become the nucleus for further growth as such clusters often show self-enforcing network effects e.g. by attracting venture capital, suppliers or service providers. The close interaction between members of a cluster may lead to higher innovation rates and thus reinforce the relevance of the cluster.

Although prominent clusters refer often to regional concentrations of high-tech industries (e.g. Silicon Valley or Greater Boston Area), the establishment and targeted expansion of clusters may apply to almost any industry. Examples in Europe include the agglomeration of apparel and footwear in Northern Italy, mechanical engineering in southern Germany or Leuven (Belgium), automotive supply in Slovakia, pulp and paper in Scandinavia, software development in Helsinki, Stockholm or Budapest, nanotechnology in Grenoble, biotechnology in Copenhagen and many more. Cluster-oriented promotion of research intensive areas with huge growth potential like Industry 4.0, greentech, biotech or nanotechnology has been part of EU sponsored initiatives (e.g. Horizon 2020) for a number of years.

However, in order to scale up European clusters and achieve a critical size that would be competitive on global scale higher investments by the European authorities would be helpful. This would require additional funding by the member states which could be made possible by a modified "Fiscal Compact" (chapter 5). The European Cluster Observatory, managed by the Centre for Strategy and Competitiveness at the Stockholm School of Economics, has done a lot of groundwork on which a pan-European cluster strategy could be built on.[4] Another building block of the European cluster strategy should be the approach of "Innovation Strategies for Smart Specialization (S3)" which is an important part of the Cohesion Policy and intends to accelerate entrepreneurial innovation processes by focusing on regional competitive strengths.[5]

Cluster Policies should not be confused with traditional industry policy that often tried to preserve existing structures and protect or promote alleged industry champions. Modern Cluster strategies view clusters as business ecosystems that have a regional dimension but comprise of many stakeholders (including established enterprises, startups, investors, research institutions etc.).[6] The scope of cluster activities usually spans several related sectors and builds a network of players and activities. A successful cluster strategy should aim for providing a policy framework that helps clusters to unfold their inherent potential. Possible policy measures are e.g. the establishment of a cluster organization, a network platform for entrepreneurs and investors, the offering of specific Research funding or the provision of a state-of-the art digital infrastructure.

The development of a holistic European growth programme will be only successful, if country specific perspectives (condensed in NGIPs) and European cluster initiatives are properly financed and executed in parallel (Figure 8).

5. A modified "Fiscal Compact"

The current SGP is based on the Maastricht criteria for government debt. Accordingly the budget deficit should not exceed 3 percent of the GDP and total public debt should not be above 60 percent of annual GDP. Figure 12 gives an overview of the current public debt situation in Europe.

Total debt-to-GDP ratio (2015) is on average at 85.2 percent for EU28 and 90.7 percent for EU19. But there is a big range from 9.7 percent (Estonia) to 176 percent (Greece). This implies that there is still a consolidation need for public households in the amount of €4.5 trillion (EU28) or €2.5 trillion (EU19) to fully comply with a debt-to-GDP ratio of 60 percent.

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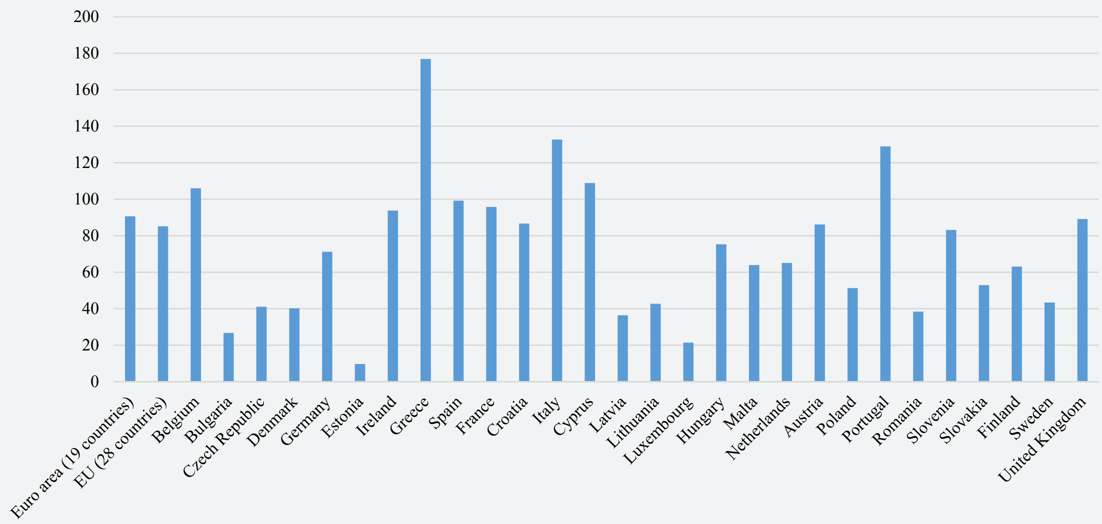
4 See Ketels, C., Protsiv, S. (2014).

5 See European Commission (2012).

6 See European Commission (2016b).

FIGURE 12

Government debt-to-GDP ratio (percent, 2015)



Source: Eurostat

As a consequence there is currently a very limited scope to increase government investments in Europe without violating or further deviating from the targets of the SGP. This gives also rise to controversial political discussions whether or not the austerity approach is still feasible particularly in light of increasing social tensions in some southern European countries. But also countries with above average income per capita and low unemployment rates face intensive debates about growing disparities of income and wealth distribution.

Therefore, it is important to increase financial flexibility both for member states as well as for the EU Commission to trigger investments across Europe and to reduce regional disparities. However the basic concept of fiscal discipline must not be jeopardized.

There is currently no different treatment between government expenditures for administrative costs, subsidies or other transfers and government investments into infrastructure or R&D programmes. In order to fully exploit the potential impact of public investments as enabler and catalyst for private investments, it should be considered to modify the current accounting of public investments in a sense that only the yearly depreciation rate of public investments rather than the gross expenditures are taken into account for calculating the yearly budget deficit. Such a modified treatment of public investments would be in line with the multi-year benefit of investments.

Table 1a demonstrates how the budget deficits would change, if government investments – defined here in accordance with the Eurostat definition as “Gross Government Capital Formation” (GGCF) – are added to the budget deficit (“adjusted deficit-to-GDP ratio”) and only the depreciation of the investments are taken into account (“net adjusted deficit-to-GDP ratio”).

The calculated numbers in Table 1a assume an average life-time of assets of five years which is on the “safe side” as the average lifetime of public investments e.g. into infrastructure would be more in the range of 10-15 years. Table 1a shows that “adjusted net deficits” would be for the EU-28 at 0.08 percent of GDP instead of 2.4 percent and for the EU-19 the budget deficit of 2.1 percent of GDP would turn into a surplus of 0.06 percent of GDP.

TABLE 1A

Impact of differentiated treatment of government expenditures

	Public Surplus(+), Deficit (-)/GDP (% 2015)	Adjusted Surplus(+), Deficit(-)/GDP (before GGCF, % 2015)	Net Adjusted Surplus(+), Deficit(-)/GDP (% 2015)	Gross Government Investments (GGCF/GDP, % 2015)
EU-28	-2.4	0.5	-0.08	2.9
EU-19	-2.1	0.6	0.06	2.7
Belgium	-2.6	-0.3	-0.76	2.3
Bulgaria	-2.1	4.1	2.86	6.2
Czech Republic	-0.4	4.8	3.76	5.2
Denmark	-2.1	1.7	0.94	3.8
Germany	0.7	2.9	2.46	2.2
Estonia	0.4	5.7	4.64	5.3
Ireland	-2.3	-0.5	-0.86	1.8
Greece	-7.2	-3.4	-4.16	3.8
Spain	-5.1	-2.6	-3.1	2.5
France	-3.5	-0.1	-0.78	3.4
Croatia	-3.2	-0.4	-0.96	2.8
Italy	-2.6	-0.3	-0.76	2.3
Cyprus	-1	0.9	0.52	1.9
Latvia	-1.3	3.1	2.22	4.4
Lithuania	-0.2	3.4	2.68	3.6
Luxembourg	1.2	5	4.24	3.8
Hungary	-2	4.7	3.36	6.7
Malta	-1.5	3.1	2.18	4.6
Netherlands	-1.8	1.7	1	3.5
Austria	-1.2	1.8	1.2	3
Poland	-2.6	1.8	0.92	4.4
Portugal	-4.4	-2.2	-2.64	2.2
Romania	-0.7	4.4	3.38	5.1
Slovenia	-2.9	2.2	1.18	5.1
Slovakia	-3	3.2	1.96	6.2
Finland	-2.7	1.3	0.5	4
Sweden	0	4.3	3.44	4.3
United Kingdom	-4.4	-1.7	-2.24	2.7

TABLE 1B

	Public Debt for GGCF (estimate % GDP 2015)	Public Debt for Consumption (estimate % GDP 2015)	Total Public Debt (actual % GDP 2015)
EU-28	32.2	53	85.2
EU-19	30.9	59.8	90.7
Belgium	22.7	83.3	1.6
Bulgaria	46.9	-20.2	26.7
Czech Republic	46.5	-5.4	41.1
Denmark	33.8	6.4	40.2
Germany	21.9	49.3	71.2
Estonia	55.5	-45.8	9.7
Ireland	30.6	63.2	93.8
Greece	41.4	135.5	176.9
Spain	36.3	62.9	99.2
France	39.3	56.5	95.8
Croatia	44.4	42.3	86.7
Italy	27.5	105.2	132.7
Cyprus	29.4	79.5	108.9
Latvia	48.6	-12.2	36.4
Lithuania	44	-1.3	42.7
Luxembourg	39.1	-17.7	21.4
Hungary	43.5	31.8	75.3
Malta	31.9	32	63.9
Netherlands	38.5	26.6	65.1
Austria	30.4	55.8	86.2
Poland	47.5	3.8	51.3
Portugal	32.1	96.9	129
Romania	54	-15.6	38.4
Slovenia	46.3	36.9	83.2
Slovakia	37.6	15.3	52.9
Finland	38.3	24.8	63.1
Sweden	43.8	-0.4	43.4
United Kingdom	28.7	60.5	89.2

Source: Own calculations

As a consequence the EU-28 could have conducted additional public investments of approximately €400-450 billion in 2015 without violating the budget deficit limit of 3 percent of GDP, if only depreciation had been taken into account. The additional headroom per country depends on the current level of budget deficits and the ratio of government investments.

The development of the additional headroom for public investments over time depends on different factors such as the treatment of past investments or fiscal multiplier effects.[7]

In a similar way public debt levels could be differentiated into those debt volumes raised for investment or for consumption purposes. Table 1b provides estimates for a split of the overall public debt levels into investment related and consumption oriented debt. To calculate these numbers I have looked into the average government investment ratios over the past ten years and deducted the cumulative government investment volumes form the public debt outstanding. This is certainly only a first approximation but indicates that from the overall debt-to-GDP of 85.2 percent (EU-28) approximately 32.2 percent can be attributed to investment financing whereas 53 percent are to be allocated to government consumption. The respective split for EU19 (90.7 percent total debt-to-GDP ratio) is 30.9 percent for public investments and 59.8 percent for government consumption. The proportion of public investments is obviously lower than for fiscal consumption.

Instead of adhering to 60 percent debt-to-GDP ratio one could split this figure into a “consumption debt-to-GDP ratio” of about 30 percent and an “investment debt-to-GDP ratio” of e.g. 40 percent. This would still imply a huge consolidation effort for most European countries but the savings measures would be targeted to reduce government consumption and would at the same time keep some headroom for public investments. With an “Investment debt-to-GDP ratio” of e.g. 40 percent government investment debt could increase in the amount of about €1.1 trillion for EU-28 and €950 billion for EU-19.

However, public households of EU-28 (EU-19) would still have to save consumptive expenses in the amount of €3.4 trillion (3.1 trillion) to reach the 30 percent government consumption target. Alternatively, one could at least consider a temporary deviation of the debt target as far as investments are concerned. This could be flanked by an agreement on a modified adjustment path to meet Maastricht criteria.

The calibration of the size and the optimal split of government expenses into an “investment debt -to-GDP ratio” and a “consumption debt-to-GDP ratio” is finally a political decision. But the introduction of a differentiated treatment of public expenses would be economically sound and could help to make the European objectives of economic “Stability” and “Growth” more compatible. A modified “Fiscal Compact” could also contribute to mitigate the controversies around austerity policy in Europe.

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[7] The exemplary calculations in Table 1a take into account only the depreciation on yearly gross investments. Results would change if the depreciation is calculated for the total capital stock. Further research is needed to analyse the impact of different accounting policies and fiscal multiplier effects.

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Rebooting Europe

Abstract

The European Union is mired in a bad economic equilibrium of stagnation and deflation – stag-deflation. While the problem is excess supply and inadequate demand, current policy, premised on private-sector-investment-led growth, aims to expand supply further through ultra-low interest rates. This is demonstrably not working. The reason is that it raises the cost of labour relative to capital, thereby destroying jobs and demand, which negates the incentive for private-sector investment. The next interest rate cut simply intensifies the deflationary pressures. At the same time, this policy is generating a debt burden that is a tinderbox for crisis. Incremental reforms will not work. Europe's policy settings need to be reset to a configuration that has worked in the past. This involves the following:

- First, re-price labour: recognizing that monetary stimulus, including quantitative easing, has not triggered interest-sensitive consumption and investment but has priced labour out of factor markets (as interest rates fall, the ratio of wage rates to cost of capital rises), remove the subsidy for investment and price labour back into the market by normalizing interest rates.

- Second, defuse the debt bomb: since raising interest rates in the context of a debt bubble would lead to a crisis, have the European Central Bank buy up excess public-sector debt and cancel it. This would remove the tourniquet on fiscal policy, allowing a return to the job-creating expansions of the Keynesian era. Moral hazard? In crisis, ignore.

- Third, redefine industrial policy by addressing the problem of adverse selection of investment opportunities: the current consensus supports investments with risk/return metrics that appeal to the private investor, leaving on the table investments that do not, but that may have strong public good characteristics. There is money on the table; Europe should seize it to restore growth, using its new-found fiscal room to manœuvre.

In Europe, as in the global economy more generally, growth has been too slow for too long. In Europe, unlike elsewhere in the global economy, this is setting up an existential crisis.

Incremental, marginal reforms that could yield a growth dividend by 2020 will be too little, too late. Brexit and electoral trends on the continent towards fringe parties, each of which is fuelled by economic dysfunction, coupled with the implications for open borders of the refugee crisis and of individual acts of terrorism stemming from the horrific consequences of regime change policies for the Middle East and North Africa, mean that the European Union—as we know it—will not live to see 2020.

Restoring growth now is critical for the European experiment. This requires a discontinuous policy shift to break the European economy out of the bad economic equilibrium of stagnation and deflation – stag-deflation – in which it is mired. Stag-deflation emerges from excess supply and inadequate demand. However, current policy, premised on private-sector-investment-led growth, aims to expand supply further through ultra-low interest rates. This is demonstrably not working. The reason is that it raises the cost of labour relative to capital, thereby destroying jobs and demand, which negates the incentive for private-sector investment. This leads to further interest rate cuts which intensify the deflationary pressures. At the same time this policy is generating a debt burden that is a tinderbox for crisis.

In every crisis lies opportunity. In existential crisis lies opportunity for transformative renewal. Europe can break out of this equilibrium by pro-active policy or wait for its hand to be forced by the onset of a full-blown economic or political crisis. Europe's economic computer needs to be rebooted and its policy software refreshed with settings restored to defaults that are known to be functional from experience. This essay sketches out how this can be done.

A Bad Equilibrium

The combination of slow growth and deflationary pressures in which Europe is currently mired is the mirror image of the stagflation – the combination of slow growth and inflation – that the industrialized world faced in the 1970s.

At the end of the 1970s, the solution to stagflation was to switch from Keynesian demand-management policies to supply-side policies. The logic was powerful: given the breakdown of the relationship between unemployment and inflation that informed Keynesian stabilization policy, the only way to achieve both lower prices and higher output was to shift the supply curve outwards.

In today's context of stag-deflation, the only way to achieve higher output without adding to deflationary pressures is to shift the demand curve outwards. The current consensus fails to see this: it recommends shifting the supply curve out, thereby hoping for growth but intensifying the deflationary pressures that are destroying growth.

This point needs underscoring. For example, the three major MGI prescriptions are investing for the future, boosting productivity, and mobilising the workforce. All aim to increase supply.

- The investments the diagnostic contemplates are by a private-sector that is sitting on trillions of dollars of excess cash and not investing because, from a private-sector perspective, it sees no profit in what is on the table.
- Boosting productivity implicitly means capital deepening – increasing capital-labour ratios at a time when business enterprises see no reason to add to overall productive capacity and when capital deepening reduces demand for labour.
- Mobilizing the workforce, including of the greying elderly, in a context of massive unemployment and under-employment of young people, simply adds to the un- and under-employment.

These prescriptions would be effective if today's problems were those of the 1970s – too much demand chasing too little supply. But today's problems are not those of the 1970s, they are exactly the reverse. Simply put, supply-side policies are the cause of stag-deflation, not the exit strategy.

To exit from stag-deflation necessarily involves a break with the current consensus on economic policy. There is no shortage of examples of such major breaks with previous policy: Roosevelt's New Deal; the creation of the Bretton Woods system; the break from the Bretton Woods system; Russia's post-Soviet "cold turkey" privatisation and marketisation; and China's opening up policy. Going back further in history, we have other examples: Britain's move to free trade with the abolition of the Corn Laws, Japan's post-Meiji Restoration embrace of western technology, and Germany's adoption of the gold standard in 1871, which ushered in a new era of globalization. Europe has arrived at such a moment.

To understand what needs to be done to shift to a new and functional equilibrium requires an appreciation of how the current policies are reinforcing the current bad equilibrium. The key factors are the relationship between wage rates and interest rates, the implications of normalized interest rates for debt burdens, and identifying neglected sources of growth. Out of this diagnosis emerges naturally the policy remedy.

The path to a new equilibrium

Repricing Labour

Since the supply side revolution, when monetary policy assumed the main responsibility for macroeconomic stabilization, recoveries have been jobless, and increasingly so from cycle to cycle. This contrasts with the Bretton Woods era, when fiscal policy was the main tool for macroeconomic stabilization and recoveries were not jobless. The very term "jobless recovery" was coined to capture this change in the behaviour of the economy.

The reason for the changed behaviour is that using monetary stimulus (lowering interest rates) to engineer a recovery works not only on interest-sensitive expenditure and investment, but also distorts the pricing of factors of production, providing an artificial incentive to substitute capital for labour. Job destruction due to technological progress or to trade liberalization leads to efficiency gains; job destruction due to subsidization of capital leads to economic inefficiency, including most importantly through the resulting under-employment of the non-subsidised factor – labour.

Job creation is the linchpin for the exit strategy since increased number of jobs translates directly into increased demand for goods and services, which in turn drives corrections across the board. This is a version of Fordism: Henry Ford recognized that mass production of automobiles depended on the masses having the income to purchase them. His solution was to pay his workers enough that they could buy the products they laboured to produce.

Appropriately restated for the European context today, the issue is to increase demand for labour. To accomplish this in the current environment requires in the first instance that labour be re-priced relative to capital. Since cutting wages is counter-productive, and since it is impractical to rewrite countless labour contracts, the expedient is to reprice the cost of capital by raising interest rates.

The structural implications of this break are profound: the focus shifts from mobilizing supply of labour to mobilizing demand for labour; from generating productivity to generating jobs; and from investing in machines to hiring people to meet new demand.

Good solutions in one area have positive spillovers in others; bad solutions create new problems in other areas. Consider how repricing labour by removing an unfair subsidy to capital redresses other manifest problems that are tearing at the fabric of today's Europe; all effects of this policy shift are positive:

- It redistributes income from capital to labour, thus reversing the income redistribution from the European equivalents of Main Street to Wall Street that quantitative easing has effected. Details aside, quantitative easing fuels price increases for equities which are disproportionately held by the wealthy, while drying up returns on bank accounts which are the principal vehicle for savings of the rest.
- It expands the tax base for governments, since the shift of income from capital – which avoids tax through technically legal tax planning, including the use of offshore accounts – to labour, which pays taxes, has a positive structural effect on tax revenues.
- By raising the returns on bank savings accounts, the principal source of household asset income, not to mention fixed income assets that support pension funds, it enables households to increase the percentage of current income allocated to expenditure – which drives aggregate demand and growth.
- It undermines the (false) claim that European integration (the four freedoms) is the cause of local job woes by correctly identifying the subsidy to capital as the culprit.

- And all this is done through market forces, through the removal of a destructive subsidy, undermining any (false) claim of heavy-handed government intervention.

Repricing labour is the linchpin for the exit strategy. However, there are other critical steps that need to be taken to enable this.

Defusing the debt bomb

The practice during the monetarist/supply side era of engineering recoveries by making money cheap has had the side effect of creating the conditions for debt crises – an excessive build-up of debt. Once an engineered recovery is deemed to have become self-sustaining, monetary stimulus is withdrawn. As interest rates rise, a debt crisis ensues, because some borrowers, somewhere in the world, overdid the borrowing, on the advice of lenders that the debt was prudent and manageable, with the encouragement of Central Banks seeking to generate productive activity.

Given the role of the US dollar as the main vehicle for international transactions and reserves, the timing of events has generally followed the US business cycle, which featured recessions in 1981-82, 1991, 2001, and for all intents and purposes in 2011 as well. The monetary stimulus introduced to counter these recessions resulted in rising interest rates in mid-decade. Shortly thereafter a financial crisis ensued: 1987 ("Black Monday"); 1997 (The Asian Crisis); 2007 (the Subprime Crisis). The 2017 crisis awaits, unless events such as Brexit extend the agony of stag-deflation by pre-empting Central Bank moves to restore normal interest rates. The epicentre of the next crisis is likely to be Europe; the trigger (Brexit, Italian banks, whatever) is not germane to the point: the debt tinderbox is there and there are plenty of potential sources of sparks. In particular, raising interest rates to reprice labour would constitute a spark.

Accordingly, Europe must defuse the debt bomb by cancelling the dangerous excess debt as part of the policy package to reprice labour. Details aside, the European Central Bank would buy up excess public-sector debt, printing euros to pay for the purchases, and would cancel the debt it has acquired. There would be no haircut for investors in government bonds. The reduction in the nominal debt burden and the budgetary allocations for debt service would render fiscally sound a number of EU member states thought to be bankrupt.

The monetary shock from debt cancellation would not be inflationary. A simple thought experiment based on the quantity theory of money explains:

QUANTITY TIMES PRICE = MONEY TIMES VELOCITY OF CIRCULATION

In an economy operating at full capacity, an increase in the money supply cannot raise the quantity of output and so must raise prices, if velocity is treated as a constant. In an economy operating with considerable slack and facing external constraints on price increases, the increase in the money supply translates primarily into an increase in output.

Europe can tolerate a significant monetary shock of the approximate scale required to restore fiscal soundness (about €2 trillion, the amount of net debt of France, Greece, Italy, Portugal and Spain above 60 percent of GDP, the Maastricht benchmark) without inflationary consequences; given the desirability of countering deflationary pressure, Europe's €15 trillion economy could tolerate an even higher shock to restore fiscal flexibility to make the growth-generating investments that have been neglected under the current orthodox industrial policies.

This may not be enough since Europe's banking system is also vulnerable. In the event of a banking crisis, the banks should be immediately nationalized, the creditors paid off, with excess debt created by national authorities purchased and written off by the European Central

Bank. After a management shake-up, the nationalized banks would be privatized; Sweden has shown how this can be done efficiently, with minimal problems to third parties.

The immediate reaction to such a proposal would be to ask "What about moral hazard?" Moral hazard theory holds the consequences of excessive risk-taking should be visited on the risk-takers. It is an important factor for the design of public policy in any area where risk is entertained by economic actors, be they individuals, firms, or governments. Well-designed policies promote sound behaviour in the normal course of events. However, in managing a potential economic crisis, especially a potentially existential crisis, conditioning policy responses on concerns over moral hazard gives this factor a weight completely out of proportion with its importance.

In three recent cases—the Asian Crisis, the subprime crisis and the Eurozone crisis—authorities have made bad situations far worse by acting in line with the moral hazard doctrine: consider in this regard the results of the IMF-dictated closure of Indonesian banks, the Lehman Brothers closure, and the transformation of the Greek debt molehill into a Eurozone mountain.

But a counter-example may work better for the reader. During the Latin debt crisis, the major money centre banks in the United States and Canada had their capital more than wiped out by bad loans. The authorities in both countries exercised "regulatory forbearance" – that is, they looked the other way, while the banks rebuilt their balance sheets. Accordingly, neither country triggered a banking crisis because of moralistic angst over moral hazard. For the United States this can be said to be the only available opportunity in its history for a banking crisis that it did not seize. Unfortunately, it did not learn from this episode and thus triggered the subprime crisis by closing Lehman Brothers. In Canada, however, where bank closures were avoided like the plague, the lessons from the "near miss" were learned and applied in subsequent regulatory reforms, enabling Canada to emerge from the subprime-triggered global financial crisis with the soundest financial system in the world. Look to Canada to understand why it is best to deal with moral hazard between crises rather than in crises.

In short, there is no reason for Europe to hit the rocks over debt, least of all because of concerns about moral hazard; all countries learn from near misses, and systemic issues of moral hazard can and should be dealt with once Europe has been restored to a new and viable equilibrium.

A second reaction would concern the fairness of such a debt cancellation. The narrative would be: "Why should countries that paid their taxes participate in a bailout of those that did not?" The short answer is that there are no tax implications of the debt cancellation and all parts of Europe will benefit enormously from the avoidance of a full-blown crisis – some directly (the Mediterranean fringe which will account for the vast majority of debt write-offs) and some indirectly, through the growth dividend which that cancellation will provide to all of Europe.

A third reaction would be concern about the reaction of financial markets. This proposal does not constitute a major break with the current consensus in favour of continued quantitative easing. However, it does transform the nature of quantitative easing by shifting the benefits from the private-sector to the public-sector. The monetary shock would imply a lower valuation for the euro; the normalization of interest rates would imply a higher valuation, as would the growth dividend from the relief from austerity policies. On balance, the euro would remain in the vicinity of parity with the US dollar, which the European Central Bank should encourage, since the last time Europe had good growth was the last time the euro was in this range.

Redefining industrial policy

Under the current consensus view of economic policy, the role of the public-sector in the economy is restricted to creating a conducive environment for private-sector activity; thus, "horizontal" economic infrastructure investment is encouraged but "vertical" or sector-specific interventions are discouraged, on grounds that governments cannot "pick winners" and other similar aphorisms and arguments based on theories about public versus private-sector governance and incentives. While governments have hardly been pure in applying this doctrine, it has had a pervasive impact on which investments are actually undertaken.

Investments do not come with horizontal or vertical stripes. They come with risk/return metrics. Some investments have risk/return metrics that will be attractive to the private-sector and some will not, for various reasons: the project might be too speculative and the risks accordingly too great or not readily quantifiable; the returns might not be realizable in a short enough time span; or the benefits might not be appropriable by the investor.

Notably, these characteristics—especiall non-appropriability—do not mean the investments lack value to society. Quite the reverse: such projects might have the greatest value to society as they are by definition projects with large public good characteristics, hence large spillovers.

Pursuing this line of thought one step further, it is important to note the combinatorial nature of innovation. As observed long ago by Henri Poincaré, new ideas emerge from combining existing ideas. The idea of recombination is actually well established in economics. Usher, in his encyclopaedic survey of inventions during the golden age of industrialization commented that "invention finds its distinctive feature in the constructive assimilation of pre-existing elements into new synthesis, new patterns or new configurations" (cited in Hargadon and Sutton, 1997; 716).

There are many examples to illustrate the point. For example, Thomas Edison's phonograph combined ideas developed by engineers working in Edison's laboratories on the telegraph, telephone, and electric motor (Hargadon and Sutton, 1997; 716). Weitzman (1998; 334) comments on the recombinant nature of Edison's inventions:

"One is struck in such stories by the central role of the hybridization of ideas. Notwithstanding the overarching importance of Edison's own inspirational genius, the very concept of an 'electric candle' appears right from the beginning as a deceptively simple cross-pollination of the idea of a 'candle' with the idea of 'electricity'… the Edison System for a complete domestic electric lighting network operating from a central power station was explicitly patterned in the inventor's mind by combining the then-novel idea of an electric candle with the established idea of a gas distribution system".

Further, the channelling of research and development into the private-sector also meant fragmentation and a consequent pass on investments that required a scale too great for private capital.

Against this background, consider the following simple thought experiment. Given the available set of ideas or inventions seeking investment, suppose there are several that can be recombined to produce new ideas or inventions. Let us further suppose that these new ideas and inventions do not meet the risk/return metrics that will appeal to private-sector investors, or are not feasible for the private-sector to undertake. Accordingly, they are passed over. However, the recombination of the passed-over ideas/inventions yields an idea/invention that is quintessentially suited for the private-sector.

One simple example suffices to illustrate that this is not a null set. The silicon chip and the Internet both emerged from the US government's defence research programme. Both projects fall into the category of investments that the private-sector would not/could not have made. Together, they enabled the creation of Google, eBay, Pokemon Go, and countless other successful private-sector computer/Internet-enabled ventures.

It is, accordingly, safe to assert that there exists an investment space that has been systematically excluded from exploration because of today's industrial policy orthodoxy. It is populated by projects that have risk/return metrics that do not appeal to the private-sector and lack the horizontal stripes that orthodoxy has mandated for selection by the public-sector. Europe has the knowledge assets to explore this space and drive new private-sector dynamism through downstream recombination of the resulting outputs.

Importantly, the selection criterion for investments is not whether they lead to immediately commercially successful projects but whether they generate new, interesting, and potentially enabling capabilities. For a working model of what this would look like in practice, Europe need look no further than the US Defense Advanced Research Projects Agency (DARPA). This programme funds a wide range of often "blue sky" projects with uncertain prospects and unclear commercial potential. Yet it is widely considered in innovation circles to be the backbone of US innovation success because of the knowledge spillovers it generates for the private-sector participants. It is the talk of the European conference circuit. Europe need simply embrace it.

Using the newly found fiscal room to manoeuvre generated by the debt cancellation to implement this investment programme would shift Europe from the path of austerity to the path of prosperity.

Discussion

The proposal outlined above is tangible – it involves a one-time debt purchase and cancellation programme by the European Central Bank to restore fiscal soundness in EU Member States that are or would be put into crisis with normalization of interest rates, coupled with a normalization of interest rates to reprice labour in European factor markets. The scale of the proposed monetary shock is within bounds that would be absorbed by increasing utilization of existing capacity, employing currently unemployed persons, and removing current deflationary pressures. Accordingly, it would not excite new inflationary impulses. The fiscal room to manoeuvre which this would create would be used for knowledge/capability generation by exploring an innovation space that current industrial policy orthodoxy has wrongly cordoned off. A working model for the industrial policy instrument is available. The combination represents a growth and jobs package tailored to Europe's current circumstances.

The proposal also responds to the risks that presently loom for the European experiment on both the economic and political fronts. Europe will not have three to five years of quiet time for reflection and refinement of potential options. The problem identified is that Europe is circling a bad point of equilibrium; the policy prescription involves a discontinuous, one-time shift to a new equilibrium. Delivering the policy shock to move Europe to a new equilibrium – in point of fact, returning Europe to a previous equilibrium that was both viable and prosperous – is feasible within weeks and months. Hopefully this will be done before Europe careens into crisis, but certainly it can be done quickly if and when crisis erupts.

Critically, the core ideas are simple and can be easily communicated to the informed lay person in the proverbial elevator conversation.

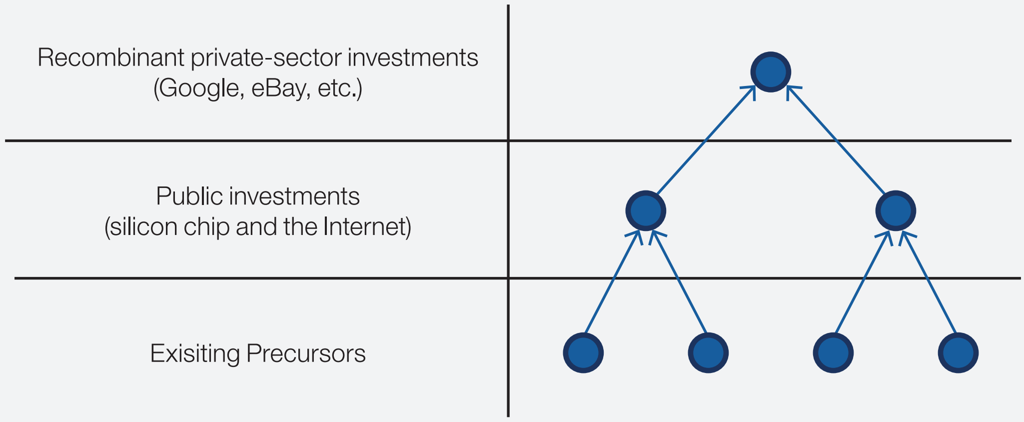
It accords with intuition that subsidization of one factor of production can lead to under-employment of a competing factor of production and general economic inefficiency. It remains to point out that cheap money subsidizes capital, leading to an artificially high capital/labour mix in production. Jobless recoveries and high unemployment are the logical consequence. This is double the 25-word limit of the board game, but short enough for the elevator ride.

It is also well understood that bankruptcy procedures, by removing crushing debt, enable renewed entrepreneurial activity. The debt cancellation proposed here, coupled with the proposal for new public investment in enabling ideas/innovations, does precisely that. This stands in opposition to, and neutralizes, concerns about moral hazard. Moreover, the idea that a debt jubilee will be required has been long in gestation and growing in acceptance, and an informed reading of economic history supports the case of addressing moral hazard when formulating rules, not when dealing with crisis situations.

The proposal for redefining industrial policy is more fundamental and the ground is less well prepared. However, it breaks out of a dysfunctional and polarized debate about industrial policy by introducing a new lens. Importantly, the key idea can be sketched on the back of an envelope (see Exhibit 1).

EXHIBIT 1

An illustration of how passed-over investments with public good characteristics screen out potential investments with private good characteristics



The proposals involve no new taxes. Taxpayers in some EU Member States will not have to pay to bailout debtors in others. This is a rather critical point in today's Europe. There will be a need, however, to explain why printing euros will not destroy the euro. The vast body of writing explaining quantitative easing and Central Bank procedures for ensuring it does not result in hyper-inflation provides the raw material for the communications programme.

The twist in the quantitative easing proposed here is that it does not benefit Europe's version of Wall Street, but Europe's version of Main Street. It redistributes wealth from the one percent to the 99 percent, as a just restitution for the massive transfer of wealth from the 99 percent to the one percent under the previous version of quantitative easing. But it does so through the impartial hand of the market as normalization of interest rates restructures returns on asset portfolios.

Similarly, while the proposal redistributes purchasing power from Europe's "haves" to Europe's "have nots" by diluting the claim of the former on overall European and indeed global production, the removal of the tourniquet of austerity policies and the resulting growth dividend for all of Europe mean that this will not be experienced as an out-of-pocket expense. Rather, it will re-invigorate intra-EU trade and investment to the benefit of Europe's north and south. There is a ready-made catchphrase here: from austerity to prosperity. And in this case, it truly is prosperity for all.

The acceptance of this policy, and the repudiation of the failed policies of austerity, are also necessary precursors to rebuilding trust throughout Europe in the European experiment.

This proposal is far from comprehensive. However, these core measures will create the enabling environment for the many useful suggestions for incremental reform in Europe that have been produced and will continue to be produced through exercises such as the present essay contest. Europe is mired in a bad equilibrium in which nothing works well. It needs to be jolted into a new and viable policy space. This essay suggests how Europe can be rebooted.

References

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EUROPE!

PRIZE WINNER: BEST ESSAY BY AN AUTHOR UNDER 30

Antoine Levy

Reforming Europe by the people, for the people: an adaptive, acceptable, and accountable reform programme

Abstract

Europe's lack of economic dynamism and mobility, the so-called *Eurosclerosis*, is not a fatality. Barriers to entry and exit for workers, firms, innovators and investors reduce the continent's ability to transition to a modern knowledge economy, and create powerful vested interests resisting change. However, there exists a potential coalition ready to challenge the statu quo ante, on the condition that they feel empowered in the design of reform through appropriate governance structures; that they be fairly represented in the distribution of their benefits; and that they be granted democratic control over their implementation.

To answer this triple-D social demand, a triple-A rating for the supply of reform processes is needed. The three guiding principles should answer the need for adaptability of the design, acceptability of the distribution, and accountability of the democratic control. This translates into very concrete and specific policy proposals, including, but not limited to: the use of European Social Impact Bonds to finance innovative provision of collective services; the compensation of losers from reforms by growth-indexed entitlements to better align incentives; the use of "opting-out" clauses for entitlement reforms, and of "grandfathering rights" to deal with transition periods; the design of "European competence clubs" of countries willing to step up integration on specific policy topics; or the recognition of relevant local scales of democratic legitimacy, including some overlapping existing jurisdictions.

Introduction: dealing with dispossession

If the cliché had not been worn-out by countless witty references, one would readily admit that a spectre is haunting Europe – the spectre of populism. The European ideal has been under attack, not merely from the outside, given foreign State and non-State violence threatening the integrity of Europe's borders and the safety of its citizens, but also and above all from the inside, **as populist movements gained steam by portraying Brussels and globalization as the sole source of their country's domestic failures, and demonizing elites and progressive ideals in the name of a lost golden age.** While one should be careful not to see in the British vote to leave the European Union the interpretation one is looking for, Brexit clearly and ominously signals the feeling of powerlessness of **those who feel most affected by the structural trends of globalization, Western de-industrialization, rising migration, and democratic dispossession.**

Economic considerations play a key role in triggering such attitudes. **Productivity growth has remained subdued, dragging living standards back, while high unemployment and an aging population have prompted States to accumulate debt in order to sustain extensive social protection schemes.** Reflecting upon this grim backdrop, many European citizens fear that they and their children will not achieve the same gains in purchasing power and prosperity obtained by the post-war generations, and that **the continent is stuck in a low-growth, weak-mobility trap, making any policy debate sound like a zero-sum game,** whereby some can only gain at the expense of other people's loss.

Guaranteeing that Europe reverts to a trend of fast, employment-creating, environmentally compatible and fairly distributed income and productivity growth requires bold reforms, both at the national level and at the continental scale. Mobilizing a larger share of the population into the labour force, improving the efficiency of public services, ensuring a fair degree of economic competition while allowing for the emergence of large-scale Europe-based companies: many of these objectives are widely shared, but the specific policy reforms to achieve them fail to gain acceptance. **While some of these measures do reach the support of a broad consensus, large segments of the population balk at the mere suggestion of most of them, either because they represent a direct threat to some vested interests, or because they involve cultural and social "leaps of faith" that many citizens are reluctant to take.**

I. A diagnosis: *Eurosclerosis* is back

For the last few decades of the 20th century – at least since the end of the golden age of post-war productivity catch-up with the United States – the main concern about continental Europe, viewed from across the Atlantic, was labelled *Eurosclerosis*. Behind this ominous name, lied a somewhat dramatic economic condition, characterized by a lack of dynamism, low growth, and weak upwards mobility. **Barriers to entry and exit were deemed omnipresent: for firms entering new markets; for workers moving across firms or jobs; for inventors creating new processes and disseminating innovative technologies; and for investors willing to finance disruptive projects.** Such obstacles allegedly prevented European nations from achieving their full potential, by hindering the reallocation of production factors and the adaptation to technology or economic shocks. Some analysts blamed it on excessively protective regulation of labour, products and financial markets, or too heavy a taxation burden; others were more fatalistic, accusing specific European cultural traits of hampering a more rapid pace of economic progress.

The global financial crisis of 2008 and its repercussions seemed, for a while, to have made such differences appear less pronounced. European politicians blamed the US's free-market institutions for the meltdown of global economic activity, and, as unemployment initially jumped to Europe-like levels in the United States, the very factors that partly account for Europe's lack of growth made it more resilient to global negative shocks. **The initial post-crisis years indeed seemed to vindicate, to some extent, the virtues of a generous social model for those affected by unemployment, of a welfare State accustomed to the use of automatic stabilizers, and of rigid employment protection legislation limiting the use of layoffs.**

A few years later, however, the sense of Schadenfreude felt by some in Europe has faded away. While the US almost fully recovered from the crisis, with unemployment moving back to its long term, structurally low level, and growth approaching the brisk pace of yore, Europe remains stuck in a stagnation trap of low economic dynamism, fuelling populist anger directed at Brussels and at traditional political institutions. **Production capacities remain under-utilized, discouraged workers have quit the labour force *en masse*, and despite the strong stimulus offered by low interest rates, a weak common currency and cheap hydrocarbon-based energies, the *Eurosclerosis*, more than ever, appears to have taken its toll on the recovery.** A few emblematic conflicts, such as those over new car-lift platforms competing with taxis services, or labour market deregulation reforms, embody the difficulties of would-be reformers to build a consensus over growth-enhancing policy measures.

II. Reforming Europe: Recreating a sense of ownership

The zero-sum trap

European leaders and civil society, when conducting reforms or discussing the state of affairs, sometimes sound as if they had gradually come to accept such a structural stasis as a fact of nature. They struggle to attenuate the consequences of the *Eurosclerosis,* rather than affect its root causes. **Political preferences – and public resources - went to protecting existing jobs and sectors, defending insiders, while ensuring some degree of static redistribution among categories and subsets of key political constituencies, rather than enhancing an agile, adaptive, and fair society.**

Reform processes, in other words, have worked on the shared assumption that the status quo ante would prevail along most dimensions, and therefore, successful political platforms have been based on a vision of society and the economy pitting "us" versus "them", natives versus immigrants, insiders versus outsiders, workers versus takers. Economic policy has been targeted towards the preservation of existing entitlements without concern for their present and future costs, and towards the protection of structures (companies, public services, or institutions) rather than individuals.

Such a stagnation trap is no longer sustainable. **It fosters defiance and distrust towards institutions and other citizens,** further hampering economic activity; **it jeopardizes the financial soundness of social risk-sharing schemes,** fuelling expectations of their eventual demise and a fear of the future; and **it excludes many of Europe's most fragile populations,** be they the young, the descendants of immigrants, or the poorly educated, from the benefits of globalization, a fertile breeding ground for anger and anomie.

"How" Europe reforms itself will determine "whether" Europe remains relevant

Growth policies, in themselves, will not solve this despair nor cure this economic angst. "Structural reforms" have long been a keyword of administrative discourse in the region, and the need for "sacrifices" and "efforts" a trope of political speeches. **A truly growth-enhancing reform programme for Europe, therefore, should not be about cherry-picking a few measures likely to marginally improve productivity, reduce frictions or complete existing markets.** Political enthusiasm and trust in national and regional institutions will not be rekindled solely by achieving a few additional basis points of GDP growth; nor will a brighter outlook on future economic perspectives for the many stem out of a visionless, technocratic reform masterplan, imposed from the top without concerns for design, distribution, and democracy.

What has been lacking is **a vision incarnating growth into visible achievements, which improve overall living standards while respecting collective and individual sovereignty.** Economic reforms should naturally aim at targeting barriers to productivity and efficiency, lowering obstacles to entry and empowering individual decision-making. But they should in parallel **strive to recreate a sense of belonging, an architecture of individual free choice and collective trust, which form the necessary underlying infrastructure to a sustained period of shared prosperity.** Successful reforms require not only skilful quantification and implementation, but also a broad understanding and ownership by vast segments of the population.

A few principles for successful reforms: triple-A for triple-D

The coalition of vested interests balking at reforms and preserving the status quo is not the only possible one. There exists a progressive, reformist majority in Europe, **ready to accept economic changes as long as they feel empowered in their design, fairly represented in the distribution of their benefits, and in command of their democratic control. To answer this triple-D social demand, a triple-A rating for reform processes is sorely needed. The three guiding principles should answer the need for adaptability of the design, acceptability of the distribution, and accountability of the democratic control.**

We shall further exemplify in the next section the interpretation of such structuring values for specific policy reforms, such as fixing our immigration systems, reducing the civil service headcount, introducing common standards for digital services or deregulating labour markets. One should already note that they constitute, to some extent, a possible answer to the questioning of current institutions embodied by the Brexit vote:

- *Adaptability* involves the need for a flexible design of policy reforms, tailored to the individual national context, rather than a common framework from Vilnius to Lisbon. Critics in the coattails of the "Leave" campaign have often argued for a greater degree of discretion and subsidiarity in the application of broad European principles.

- *Acceptability* suggests that when reforms, such as further trade openness or deregulation of licensed professions, are likely to produce aggregate gains, the distributive impact of their implementation should be a key element of the discussion. The geographic and sociological map of the "Leave" vote has amply demonstrated that even when overall growth is relatively strong, distribution matters in its political sustainability.

- *Accountability* means that no reform should go without correlated representation: populations affected by policy measures should have a say in their elaboration ex ante, but also in the control of their success ex post, so as to make those in charge responsible for the medium-term consequences of their actions.

Beyond the GDP factory

Comparing best performers and conducting a rigorous diagnostic of Europe's binding constraints to growth, helps to identify a number of levers apt to increase the continent's productivity potential. **Europe, when compared as a whole to its natural counterpart, the United States, does not lack the necessary production factors in a modern knowledge economy, such as skilled labour, sound institutions and intellectual capital. Rather, it suffers from a relative disadvantage in mobilizing and allocating these ingredients into efficient production and trade activities.** Most of the reforms identified by the June 2015 *McKinsey Global Institute's* report on unleashing Europe's growth potential revolve around either a better mobilization of labour (be it senior and young labourers, or relevant immigration targets), capital (such as public investment in infrastructure, or R&D expenditure funding), or improved allocative efficiency (via increased trade openness, standardization of norms and fair competition throughout the single market, or streamlined management of public services).

Europe, however, is not a single, large GDP factory, where mixing the ingredients in the right way would magically produce a manna from heaven called economic growth. It is also a complex polity of diverging interests, a confluent of cultures, social models, and traditions, and above all, the original locus of a democratic conception of political action. **If reforms are to achieve significant strides in Europe's way to a more prosperous economy, they should take into account these national differences and this need for legitimacy;** for, if they don't, policymakers will soon be reminded that a well-functioning market economy can only thrive when embedded in networks of social trust, solidarity, and respect for its governing institutions.

III. Adaptability, acceptability, and accountability in action

Any successful reform plan should strive to meet the triple-A rating of large-scale economic policy changes: it must be *adaptive*, *acceptable*, and *accountable*. In this section, we explore some of the potential applications of these three principles to specific economic policy measures, and the way they would help align political economy incentives with growth-enhancing reforms.

1. Design is key: the role of adaptability

The first keyword to keep in mind when designing reforms to boost Europe's growth potential is adaptability. The fiction of a one-size-fits-all, uniform policy programme to be applied throughout Europe, must be abandoned: national traditions, social structures and past trajectories matter when designing the appropriate steps of a reform process tailored for an individual country.

Transforming EU institutions into a policy fablab

European institutions should no longer be perceived as a blind administrative bureaucracy, but as a field for experimentation and interaction. They should focus on **promoting best practices of governance and reform across the continent, by analysing, selecting and advertising successful reforms in specific member states or areas,** and reflecting on how best to adapt them to other national contexts.

With such a trial-and-error mind-set, European institutions will be able to promote true convergence, not only in fiscal or monetary stability terms, but on competitiveness, regulation, and democratic processes. They should convert into a repository of successful "best practices", rather than impose a single "Brussels consensus" broad reform programme to each and every European economy while overlooking structural differences.

EU institutions should have the objective of turning into a policy fablab, where new measures are experimented, evaluated and adapted to specific national contexts. In practice, **specific Europe-wide contests for the innovative provision of public services, financed by European Social Impact Bonds, would do a lot both to foster a spirit of innovative efficiency in fields where it is currently lacking, and in improving the image of European institutions** in the mind of the continent's citizens. European Social Impact Bonds would constitute a mild form of debt mutualisation, but would however remain acceptable to guarantor countries because of their success-based formula: financing would only be offered to those projects likely to economize on future public funding while improving growth and prosperity outcomes in fields such as education, professional training, or healthcare.

Similarly, in each major field of governance, instead of a council of European ministers which tends to veto any kind of reform not in accordance with its own national government's policy orientation, one could suggest **the creation of transparent lists of potential reforms. Such European Reform Repositories would not be binding: on the contrary, each country could choose to adopt and adapt a number of them,** while taking advantage of the diversity of national traditions and institutions to obtain feedback and evaluation from each national experiment with adaptive reform frameworks. **Reforms would then be ranked according to clear criteria of success, and European structural funds would be allocated in priority to countries willing to adopt those which have proved the most efficient** across the continent.

A European league of competence clubs

From a governance perspective, Europe should no longer aim at fully centralized integration in all respects and across all topics of governance. Rather than a multi-speed Europe, what is sorely needed is an acknowledgment of the diversity of goals and objectives targeted by communities throughout Europe, upon the background of common principles and values. **Europe should take into consideration the existence, within its internal market, of converging interests across subsets of nations, regions, or cities, and allow them full flexibility to associate within "European clubs" and pursue further growth-enhancing reforms, without requiring the participation of each and every member state.**

Such "competence clubs" would be based upon two basic tenets. **The first one would be a "ratchet principle": these arrangements could only be concluded in order to secure more integration than the baseline European model,** rather than less, across their members. This would avoid a disaggregation of existing successes of the single market through the formation of "Eurosceptic" clubs. **The second principle would involve a "free entry criterion" for EU members: any member state or region should be able to join**

a club if it asks to (and only EU member states should be allowed to join), in order to maintain the long-term objective of full integration and avoid the partition of Europe into exclusive sub-unions.

One could, for example, apply such competence clubs to the case of immigration policies. It has long been argued that better adapting the immigrant population intake to the economic needs of European countries is a legitimate objective, apt to improve labour-market matching of immigrants and reduce the risks of immigration for the financial soundness of benefits schemes. An immigration "points system", with clear weights given to experience, training, industry or other characteristics could help objectivise the debate over immigration and undercutting populist slogans. However, full convergence of all 28 member states on the criteria to be weighted is unrealistic within a reasonable period of time. **Therefore, the creation of a "competence club" specifically targeted towards the creation of a common immigrations points system would help to bring together those countries with sufficiently close immigration needs and political values that they are willing to take a step in the direction of further integration** of their immigration policy, without requiring the consent of each and every European member state.

2. Distribution matters: the need for acceptability

Truly beneficial, growth-accelerating reforms are likely to foster gains and losses, by reducing protections for bastions of low productivity in licensed occupations, by increasing turnover at the firm, worker, and industry level, and by facilitating the reallocation of labour, capital, and property rights, and the adoption of new production methods and technologies. Therefore, acknowledging trade-offs rather than sweeping them under the carpet, and offering compensations to losers in order to gain their support and willingness to reform is key to a successful reform programme.

Compensating losers: the role of frontloading

Would-be reformers should drop the convenient political fiction of unanimity, and the pretence of contenting every stakeholder with a single, one-size-fits-all reform. **Opening protected industries to foreign trade, or reducing distortive subsidies to socially wasteful activities or products represent canonical examples of reforms which are likely to produce aggregate growth gains, but also to have deep distributional effects** and generate uncompensated losses for some segments of the population. Such diverging interests are a normal by-product of reforms in modern economies, where most low-hanging fruits have already been seized and the activation of remaining growth levers involve harder trade-offs.

Neglecting or denying these trade-offs is of no help. On the contrary, reformers should avail themselves of the margins of manœuvre offered by growth-oriented reforms to compensate losers in an innovative and incentive-compatible way. **Moreover, such compensations should be, as much as possible, frontloaded: the longer governments wait to compensate losers, the larger the losses they have incurred, and the more entrenched their opposition becomes.** Taxi services are a case in point of the cost of back loading: while reasonable compensation for their lost monopoly rights could have been envisaged when some forms of competition began to appear, governments in most European countries chose to postpone the problem, only to find out years later that the value of the required compensation had only gone up as competitor services gradually drove down the value of monopoly rents to next to nothing.

Compensating losers: innovative growth-indexed entitlements

“Paying to reform” should therefore never be a taboo, all the more so when the (concentrated) costs of buying back rents are low compared to the expected (but diffuse) benefits of deregulation or opening up to competition. Besides, **innovative financing schemes can have relevant applications in the process of buying-back rents: for example, offering GDP growth-indexed shares to workers in industries affected by foreign competition would help to align their incentives with those of the broader national community.** Growth-indexed entitlements, in general, would have many benefits both for governments (by virtue of their counter-cyclical burden on public finances) and for those who receive them as compensation, by ensuring that their objectives better match those of the general public rather than opposing narrow interest groups.

Offering opting-out possibilities

Making reforms acceptable also requires offering citizens and affected constituencies a say in the process, for example through opting-out possibilities, or through the granting of “grandfathering rights”.

Opting-out of democratically accepted reforms should always have a cost, in order to avoid secessionist tensions and the temptation to simply withdraw from the national community. One example of an area where “opting-out” possibilities would be likely to improve the buy-in of those affected by the reform is the protective status civil servants enjoy in most European countries. Some countries, with a view to reduce civil service figures, while not reneging on their implicit or explicit pledge of life employment for their members, could offer the option of selling away the special status, effectively buying back rents. **An auction system could be designed to achieve specific headcount reduction objectives, with those tendering their status being offered a buyback amount, up to the point when the global downsizing target has been met.** Thus, civil servants who are unwilling to abandon their protective status at any cost would be able to opt out of the reform process, but they would lose their rights to compensation.

When designing the structure of individual choices, however, lessons from behavioural economics should be taken into account. If one believes that individuals sometimes fail to choose the best path for themselves and society, because of a lack of information or anticipation capacity, then **default options or other “nudging” mechanisms must be considered in order to channel the choices of those least informed in the direction of growth-improving outcomes, without denying them the right to individual choice, a necessary condition for political acceptability.** This is the case, for example, for retirement decisions: since the individual retirement decision exerts an externality on social benefits schemes by reducing contributions and increasing expenditures, default options for the retirement age should be set towards the higher end of the targeted range, while offering the individuals the possibility to opt out of reforms raising the retirement age if they are willing to do so, at a pre-determined cost for their pensions.

Grandfathering rights to deal with transition periods

Another useful technique to provide compensation to those affected by a reform without losing its broader benefits comes in the form of “grandfathering rights”. **“Grandfathering rights” give specific attention to transition periods, by allowing those who wish to do so to protect their existing status during a reform.** One potential application of these grandfathering rights would be to labour market regulation. Some European countries could, through a “competence club”, decide the creation of a unique labour contract, with gradually increasing rights to social protection, with a view to replace the existing multiplicity of contracts. While incentives would be offered to those willing to join the new type of contracts, and **they would constitute the standard for newly concluded transactions, the rights of workers holding existing legacy contracts would be preserved during the transition period, to avoid rushing unacceptable changes** on those who made a decision based on former regulations.

3. Democracy at the core: the thirst for Accountability

Ensuring that reforms are acceptable beforehand by a vast majority, and that their conduct takes an adaptive and non-ideological form, are necessary, but not sufficient conditions for success. In addition to adaptability and acceptability of the reforms, guaranteeing their long-term sustainability, both economic and political, requires that politicians and administrative agencies in charge of their implementation remain accessible and accountable to the people throughout the reform process. Mass support for reforms can only come through the legitimacy of a clear mandate, the recurrent appeal to the people to validate the path taken, and a commitment to review the outcomes regularly and change course if necessary.

Independently reviewing objective success criteria

Pro-growth reforms are often based upon the explicit or implicit pledge that short-term pain will produce medium-term gains. However, to ensure their legitimacy and preserve a broad consensus, the gains must be measurable against clear, predetermined success criteria. Only with such benchmarks against which to gauge the success or failure of a reform, and a credible commitment to change course or even reverse policies in case they are not met, will reforms gain broad acceptance.

The feeling of elite-sponsored reforms being imposed "from the top" without any regard for their actual effectiveness on the ground is one of the key drivers of the loss of legitimacy of growth-enhancing programmes. **Committing to the evaluation of results against clear, pre-determined success criteria is a way to tie a government's hands *ex ante,* by ensuring that unsuccessful reforms will be phased out *ex post*.** Such an evaluation could be delegated to independent administrative authorities, less subject to regulatory capture by either politicians or affected interest groups. The design of success criteria should take into account existing evaluations of policy reforms. It should also select quantitative measures of success that are least subject to manipulation or misreporting by government, in order to preserve the legitimacy of the independent evaluation process.

Introducing sunset clauses

Similarly, the introduction of sunset clauses (or, when more relevant, regular review clauses) for laws and rules, in order to revise them and avoid locking-in future generations of voters, provides powerful support for change against the status quo. One of the main opposing arguments to growth-enhancing reforms lies in their definitive character, and the risk that they will no longer be adapted in a few years' time. **A pre-determined schedules of reviews and resets thus preserves the interests and freedom of decision of future generations, while offering a chance to experiment with reforms for a given period of time.**

As an example, specific tax breaks to encourage research and development funding are often accused of having lesser and lesser incentive powers while incurring ever increasing costs. Introducing sunset clauses for such measures would therefore help frontload their impact on research financing, while offering the option to phase them out if their efficacy proves to be on a declining path within a few years of implementation.

Identifying the relevant level of political representation

Accountability entails the recognition that the relevant scale of political legitimacy should evolve with the state of technology, social and geographic mobility. Geographic nation-state borders are not always the most appropriate level of economic decision-making, since regions overlapping several states may have common economic interests and would benefit from mutually advantageous reforms.

Thus new reform plans must be matched to a corresponding level of democratic involvement and control, be it at the city, regional, national or supra-national scale. This implies that **a fair degree of subsidiarity should be granted to cities or regional governance structures to hold their own voting consultations on reforms that can be implemented at a local level, such as new infrastructure investments or specific local tax incentive plans.** Such subsidiarity could for example be materialized by **a European charter of local government rights, guaranteeing the recognition of policy measures implemented at the local level by all European partners, and facilitating the option of holding trans-national consultations over relevant policy reforms.**

Indeed, a better match between the scale where political sovereignty is exercised, on the one hand, and the relevant level of economic decision-making, on the other hand, would be a major step in the direction of improved accountability of pro-growth reforms. It would partly alleviate the current feeling of dispossession of those who feel that decisions taken at the national or European level do not correspond to their best interests, and ensure that appropriate programmes are implemented, even though on a smaller scale, when a national consensus cannot be built within a reasonable timeframe.

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Conclusion

Declaring that European societies now find themselves at a crossroads has become commonplace; it is no less true. The choice between long-run stagnation, fuelling populism and resentment, or a bold pro-growth reform plan, cannot be postponed for much longer. Inclusive reforms must better mobilize resources and allocate them throughout the continent, while broadening individual and collective perspectives. **Growth is not, or not only, about an additional decimal point of GDP; it will provide the occasion to build a fairer European society, able to preserve the specificities of its generous social model without jeopardizing its long-term prosperity.**

We outlined the triple-A principles that we believe are central to the political economy a pro-growth reform programme for Europe. **Adaptability** involves the acknowledgement that the relevant scale of political imagination and belonging needs no longer be the same for all types of reforms: while some are better dealt with at the supra-national level, others require a national consensus, while some would be better suited to a city or region scale. **Acceptability** includes the need to compensate any potential losers and direct a fair share of attention towards transition periods, rather than ignoring the fate of affected constituencies in the name of large aggregate gains. **Accountability** notably means that reform success should be measured by distinct, quantitative and qualitative criteria, and unsuccessful reforms should be abandoned, reversed, or redirected upon not meeting such requirements.

A few structural propositions should naturally follow from these principles. Hard choices, resource trade-offs and conflicting interests must be acknowledged and openly debated, rather than discreetly swept under the rug, hoping no one will notice. Potential losers must be compensated, and transition periods should not be lightly discarded as mere impediments on the road. Individual choices should be respected, while channelling decisions in the direction of the broader community's interests. Existing institutions must be questioned, and, if necessary, replaced by more appropriate and finer governance structures, precisely tailored and adapted to their objectives. Democratic rules that preserve the interests of local communities and future generations are necessary for reform programmes to gain broad acceptance. Reforms should avoid locking in future generations, remain flexible in their design, and offer the opportunity to change course if results are not living up to expectations.

Reforming Europe to achieve its full growth potential will involve affected constituencies at any point in time, from the conception of the reforms to their implementation and evaluation, to allow citizens to own the reform process, rather than feeling threatened or overwhelmed by outside, top-down widespread changes. Defiance against opaque decision-making and smoky backroom deals shall only be overcome by a radical effort in favour of transparency, legibility and involvement of European citizens.

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Pascal Lamy was General Director of the World Trade Organization (WTO) from 2005-2013. He was Chief of Staff for the President of the European Commission, Jacques Delors, from 1985 to 1994. He subsequently served as CEO of Credit Lyonnais until 1999, before returning to Brussels as European Trade Commissioner until 2004. He chairs or serves on multiple boards internationally and has repeatedly been ranked among the world's most influential thinkers.

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Previously, starting in 1985, he held various positions at Société Générale de Belgique, including President, Vice Chairman, and Vice President Suez-Tractebel after the merger of Société Générale with Tractebel. From 1977 to 1984, he was Vice President of the European Economic Community's Commission and Commissioner for Industry. Prior to that, he was President of the International Energy Agency and chief of staff at the Ministry of Foreign Affairs for Ministers Paul-Henri Spaak and Pierre Harmel.

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Henrik Enderlein is Associate Dean and Professor of Political Economy at the Hertie School of Governance and Director of the Jacques Delors Institut - Berlin. Since 2013 he is member of the independent board to the German fiscal council ("Stabilitätsrat"). Henrik was Junior, Visiting, or Full Professor and Chair at the Free University Berlin, Duke University, and John F. Kennedy School of Government of Harvard University.

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Reiner Hoffmann, President of the German Trade Union Confederation (DGB)

Reiner Hoffmann was elected President of the German Confederation of Trade Unions in May 2014. Previously, he worked at the European Economic and Social Committee and the Hans-Böckler Foundation, and served as Director of the European Trade Union Institute (ETUI) in Brussels, as Deputy General Secretary of the European Trade Union Confederation (ETUC), and as regional Chairman of the Industrial Union for Mining, Chemicals and Energy for the district of "Nordrhein" in North-Rhine Westphalia.

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Eric is a senior partner of McKinsey & Company, based in Paris, and chairman of the McKinsey Global Institute. He was the managing director of the France office from 2002 to 2010, led the firm's global knowledge and communications function from 2010 to 2013, and has been a member of the Shareholders council of the firm for nine years. He has been leading research on growth, employment, digital, and diversity. Eric works extensively for clients in the telecom, media, high tech, and energy sectors as well as for public and health institutions. Eric was a member of the Commission pour la Libération de la Croissance Française (Release Growth in France) and of the Commission Economique de la Nation (French National Economic Commission).

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Andrew Palmer is the business affairs editor at The Economist, where he has responsibility for the newspaper's business, finance and science coverage. Among other roles he was previously the newspaper's finance editor and Americas editor. He has authored special reports on international banking, property and financial innovation. He is the author of Smart Money (Basic Books, 2015), a book on the good that finance can do.

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Geneviève Pons took up her position as Director of the WWF European Policy Office in July 2015. She is a honorary Director of the European Commission. During her 22 years career there, among other roles, she was in charge of environment and climate matters in the cabinet of Jacques Delors, whom she accompanied to the Rio Earth Summit in 1992. In her present function she represented WWF EPO in New York for the adoption of the 2030 Agenda and attended the COP 21 conference.

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Sven Smit is a senior partner in the Amsterdam Office of McKinsey & Company. He leads our Western European region, and has decades of experience in serving telecom, high-tech and industrial companies across the globe. Sven is an expert on growth and performance as a co-author of "Granularity of Growth" and has wide experience in strategy and transformation of enterprise wide scale. Sven leads our perspective on the global economy, and develops global and country GDP scenarios leveraging our unique global growth model, anchored by 130 variables of consistent statistics over 30 years.

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Ewa Szmidt-Belcarz is the CEO of Empik Group, the largest books, media and entertainment retailer in Poland. In 2015, she has been named one of the top 50 most influential women in Poland by Home&Market magazine. Before joining Empik, she was the first woman Partner at McKinsey & Company in Poland, and she worked in brand management at Cadbury Trebor Bassett in the UK, Henkel & Schwarzkopf in Germany, and L'Oreal in Poland.

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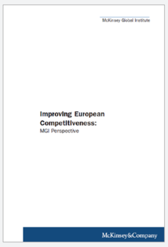
- 1993 — Internal border controls removed as Single Market comes into operation
- 1994
- 1995 — Austria, Finland and Sweden join the EU; Free movement of people under Schengen agreement
- 1996
- 1997
- 1998 — Establishment of European Central Bank
- 1999 — Euro is launched
- 2002 — Euro notes and coins come into circulation
- 2003



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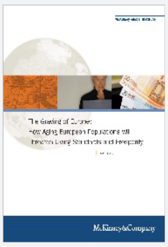

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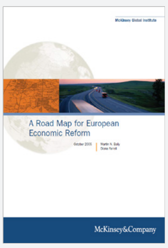

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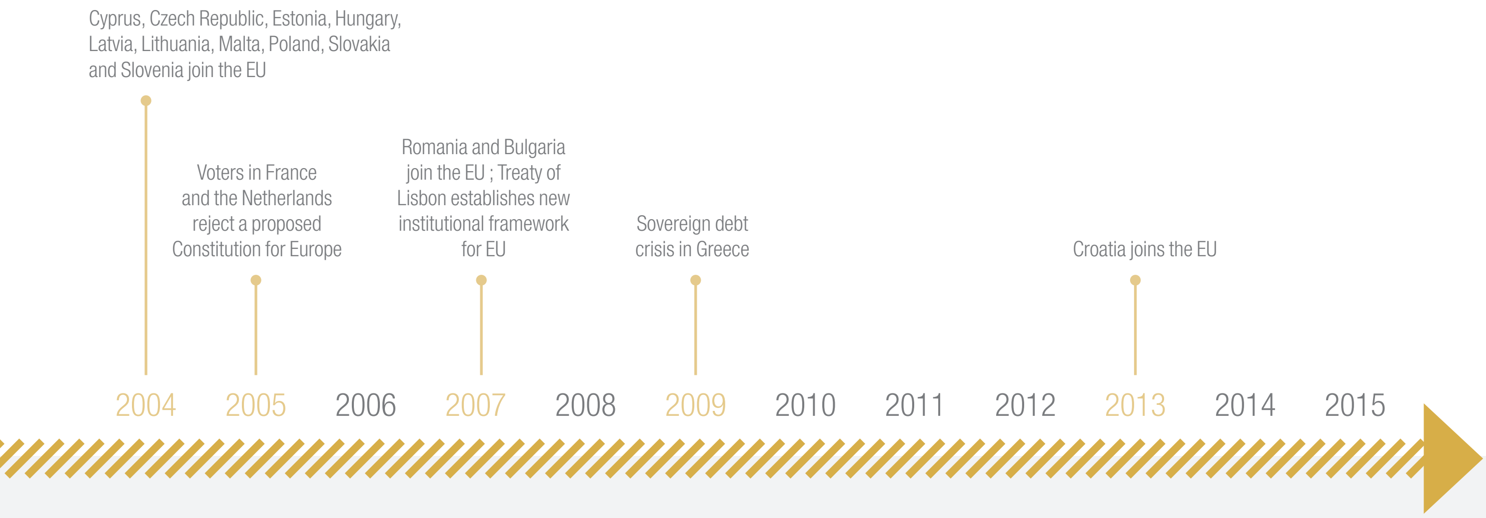
To maintain adequate social programmes, Europe must restore full employment and generate economic growth through regulatory reform.

Investing in growth: Europe's next challenge (December 2012)

Private investment was the hardest-hit component of Europe's GDP between 2007 and 2011—but it can also be a major driver of the region's recovery.

Digital Europe: Pushing the frontier, capturing the benefits (June 2016)

Europe is operating below its digital potential but can add €2.5 trillion to GDP in 2025, if it boosts the intensity of its use of digital technologies.

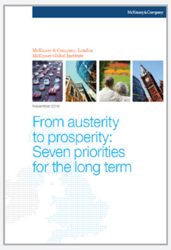


Removing barriers to growth and employment in France and Germany (March 1997)

Sluggish growth in the mid-1990s threatened France's and West Germany's prosperity. This report shows that the main barriers to growth were product market regulations that stifled innovation and high minimum wages that discouraged hiring.

Driving productivity and growth in the UK economy (October 1998)

The United Kingdom's output per capita ranked last among G7 countries in the mid-1990s. The chief causes were low levels of competitive intensity, product market and land use regulations, and in some cases, managerial practices.



From austerity to prosperity: Seven priorities for the long term in the United Kingdom (November 2010)

Prospects for economic growth in the United Kingdom are strong, pro-vided that bold action is taken to remove key barriers.

Boosting Dutch economic performance (September 1997)

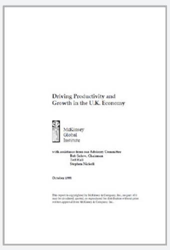
Despite impressive growth in employment after 1985, the Netherlands still trailed many Western European economies in terms of GDP per capita. Six barriers, including lack of competition and obstacles to business development, stifled output and employment growth.

How offshoring of services could benefit France (June 2005)

To capture more of the potential benefit from offshoring, France must focus on creating the jobs of tomorrow and increasing the flexibility of its labour market.

French employment 2020: Five priorities for action (March 2012)

France must create more than twice as many net new jobs annually as it did during the past 20 years.



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Reinvigorating industry in France (October 2006)

The picture that can be painted of French industry may be a cause for some concern—a relative industrial decline, but a more worrying loss of competitiveness.

Growth and renewal in the Swedish economy (January 2013)

Analyses Sweden's economy, which is faring better than many of its peers, but to compete in the long term, the nation must address five key issues.

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