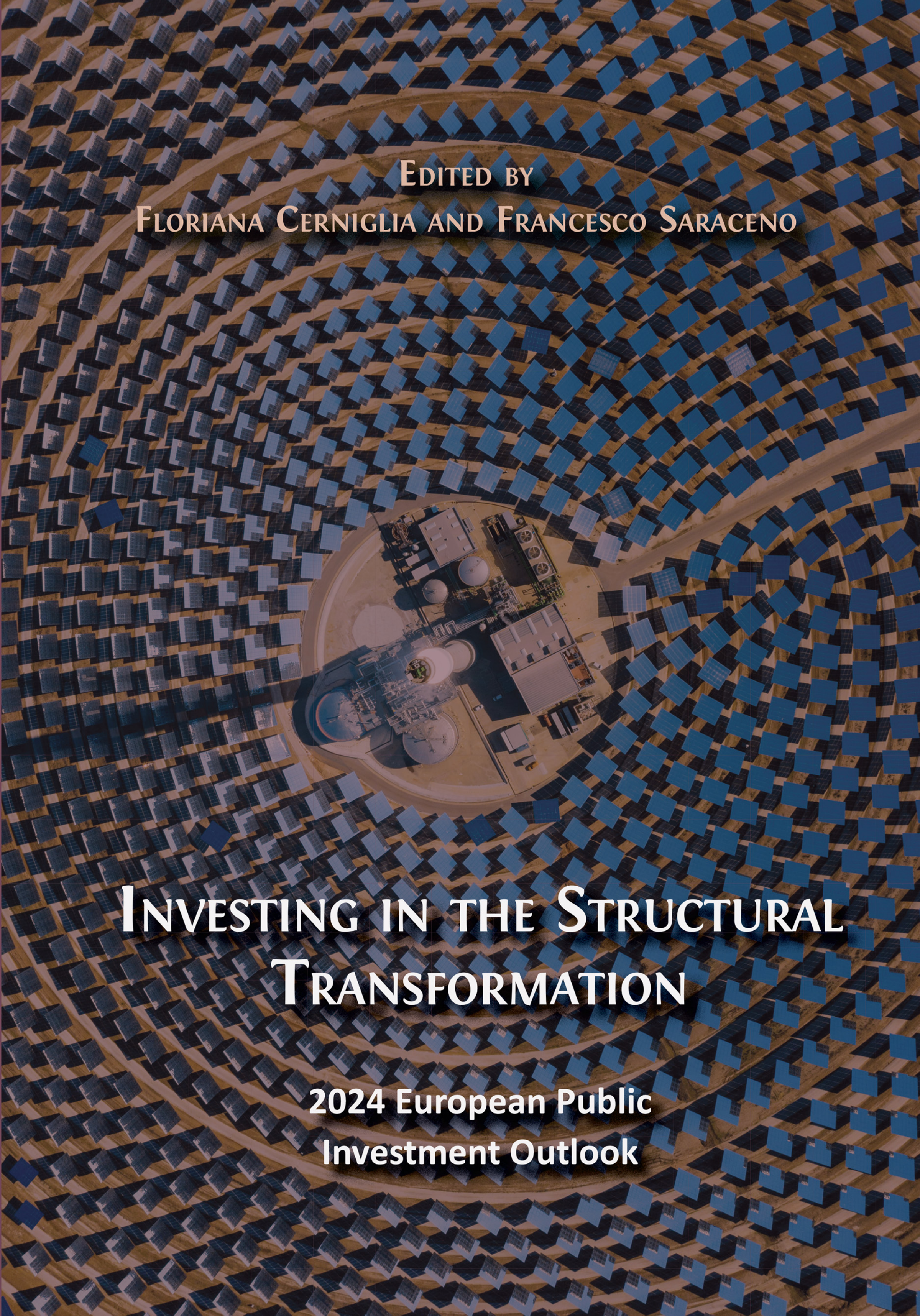

Edited by
Floriana Cerniglia and Francesco Saraceno

Investing in the Structural Transformation

2024 European Public Investment Outlook

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Introduction

Floriana Cerniglia[1] *and Francesco Saraceno*[2]

Investing in the Structural Transformation is the fifth *European Public Investment Outlook*. The multifaceted impact of the changing global scenario on Europe and its Member States is the Ariadne's thread that runs through this *Outlook* which focuses on industrial policy. At the end of 2024 the European economy is, once again, at a crossroads. While many European Union governments are engaging in more or less draconian fiscal consolidation plans to bring down public debt, the publication of the Draghi (2024) report on productivity in September 2024 has highlighted a completely different set of priorities. The report's starting point is the diagnosis of an increasingly evident growth gap that has been opening between the EU and its main competitors (mainly the United States and China)—a gap that the former European Central Bank (ECB) president rightly attributes to a chronic stagnation of productivity growth, for large and small countries alike.

Furthermore, the report highlights what has been apparent to most economists and practitioners for at least half a decade, but is only now gaining the attention of the media and policy makers: boosting productivity requires a more efficient organization of the European economy, most notably concerning the single market. And, of course, the layers of regulation and constraints that have accumulated over the past decades have become a drag on growth and need to be reorganized and rationalized. In short, it goes without saying that boosting productivity is not just a question of resources. Nevertheless, the Draghi report is unambiguous about this, it is impossible to imagine that the digital and green transition, and making up for the lost ground in terms of productivity and growth, can be implemented without massive investment (Cerniglia and Saraceno 2022). The team working on the Draghi report quantified these resources in around €800 billion per year (around 5% of EU GDP), of which more than half would have to come from public investment (for numbers in a similar ball park, see Baccianti 2022). The existing evidence, in fact, quite robustly points to the fact that public investment crowds-in private capital. This happens, on one side by providing a stable macroeconomic environment; and on the

1 CRANEC—Università Cattolica del Sacro Cuore (Milan).

2 Observatoire Français des Conjonctures Economiques (OFCE) Sciences Po and Luiss Institute for European Analysis and Policy (LEAP)

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other side by increasing the expected profitability of private investment; the crowding-in effect is even larger when uncertainty is higher, so, typically during periods of structural transformation like the one that lies ahead for the European and the world economies (Durand et al. 2021).

The sequence of crises that has shaken the world and European economies since 2008 has belied the faith in the markets' ability to converge to the natural equilibrium that characterized the consensus in macroeconomics before the Global Financial Crisis. The long period of supposed "Great Moderation", characterized by stable growth and inflation, led some economists to speak somewhat imprudently of the end of history.[3] However, this period actually fostered growing inequality and financial fragility, issues which, when they eventually emerged into the light of day during the Global Financial Crisis, exposed the inability of markets to allocate resources efficiently and to integrate long-term constraints such as environmental and social sustainability into their behaviour (Saraceno 2023).

The long overdue "Rethinking Macroeconomics" process (Blanchard 2016) set in motion by the crises is not over yet, and it is unclear whether a new consensus will emerge. However, the repeated, evident inability of markets to coordinate on stable and satisfactory equilibria suggests that, in the future, theoretical models will foresee a role for economic policy in pursuing socially desirable outcomes. Depending on the circumstances, this can be accomplished by supporting markets, guiding them, and sometimes even replacing or counteracting them.

In particular, since 2008 a prominent role has been assumed by fiscal policies, that had been relegated by the pre-crisis consensus to a closet: first, during the Global Financial Crisis, with "standard" Keynesian policies to support aggregate demand. Then, with the attempt to pull the economy out of the chronic demand shortage that characterized advanced economies since the early 2000s (the *secular stagnation hypothesis*, see Platzer and Peruffo 2022 and Holston et al. 2023). Again, with the renewed attention paid to the importance of global public goods (e.g. health care, social protection, education; see Buti et al. 2023, Hemerijck et al. 2020), to avoid economic and social collapse during the COVID-19 pandemic. Last, but certainly not least, with the return in force of industrial policy and public investment: to cope in the short term with the disarticulation of the world economy induced by the pandemic, by inflation, and by repeated geopolitical shocks; and to facilitate and guide, in the long term, the ecological and digital transitions (Buti et al. 2023; Cerniglia and Saraceno 2022). It is interesting to observe, as a side note, how this return of fiscal policy largely eludes the dichotomy taught to students of economics between structural policies for the supply

3 "My thesis in this lecture is that macroeconomics in this original sense has succeeded: Its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades. There remain important gains in welfare from better fiscal policies, but I argue that these are gains from providing people with better incentives to work and to save, not from better fine-tuning of spending flows" (Lucas 2003: 1).

side and monetary and fiscal policies for the demand side: industrial policies, as well as the policies protecting consumers and businesses adopted first during the pandemic and then during the inflationary episode, which could be defined as "expansionary fiscal policies for the supply side", require a new economic theory that has yet to be elaborated (Blot et al. 2024).

Fiscal policy for the supply side, which is relevant for the topic of the current issue of the *European Public Investment Outlook*, also involves investment in that it contributes to shaping the economy in the long run. Mazzucato's (2013) "Entrepreneurial State" has a role in fostering innovation and productivity growth that goes well beyond the standard compensating for market failures. The State, according to Mazzucato, has some features which private enterprises, including venture capitalists, do not have. First, it is patient, in the sense that it can wait long periods of time before reaping the returns for investment. Second, it does not maximize profit, but social welfare; third, even if Mazzucato does not mention it explicitly, it has deep pockets, and capacity to raise debt (Cerniglia et al. 2023). Because of these features, the State, according to Mazzucato, does much more than the simple standard tasks of tackling market failures (like providing public goods, or standard Keynesian aggregate demand support). In fact, it provides the economy with the essential task of exploring possibilities that markets would *never* explore, even absent market failures.

Thus, industrial policy cannot be reduced to simply enabling markets, for example by levelling the playing field and by eliminating or at least reducing rents and market power (which is the doctrine that prevailed within the European Commission in the past); nor can it be reduced to fostering the creation of large oligopolistic conglomerates to compete for market shares.[4] Industrial policy rather needs to be a multidimensional strategy to favour structural transformation and reduce bottlenecks in strategic sectors, facilitating the creative destruction process that reallocates resources from low-productivity activities to sectors that are strategic for geopolitical reasons, and/ or for managing the green and digital transitions. This approach is spelled out by K. Aiginger in Chapter 6, which discusses the need for a new industrial policy for the green transition. Aiginger critiques past industrial policies—whether sectoral (French) or horizontal (German)—and examines their relevance in today's context. The chapter advocates for a modern industrial policy that transcends traditional boundaries between manufacturing and services and is tailored to diverse economic and regional contexts. Emphasizing resilience, sustainability, and inclusivity, this policy must align with societal needs and the Sustainable Development Goals (SDGs), rather than focusing solely on GDP growth. It also stresses the importance of international cooperation over protectionism. While populist movements may push for nationalistic approaches, the chapter argues for a globally oriented policy driven by education, green innovation, and societal well-being to address the profound

4 It is reassuring, in this sense, that the Draghi report emphasizes productivity rather than competitiveness, rejecting the idea that growth is a zero-sum game.

transformations of the twenty-first century. R. Cherif, F. Hasanov, and X. Li develop Chapter 7 along similar lines, discussing what this new industrial policy should look like in the European context. The authors note that problems for EU countries are not limited to the so called "peripheral" countries: since the 2008 Great Financial Crisis, the core countries have been losing their competitive edge in the global market for sophisticated industries such as electronics and green transportation and power technologies. Meanwhile, the peripheral European countries have been slowing down and in the pre-crisis period have mostly channelled their investment into non-tradable industries, concentrating their resources in low productivity and low skill activities. For the EU, the implication at the macroeconomic level is the appearance of dislocating forces: the faltering of the engine of growth, internal trade imbalances, and a convergence slowdown (if not reversal). The lessons of the so-called "Asian miracles" and the earlier European growth experience suggest reigniting business dynamism by spurring innovation, scaling up, and production in sophisticated industries, reorienting the engines of growth of peripheral economies toward exports to the European and global markets and linking up with complex value chains, and changing the mindset of the European institutions from a focus on government failures to tackling market failures in sophisticated sectors with resources steered toward them.

The other chapters of the 2024 *European Public Investment Outlook* deal with specific sectors that are particularly relevant in the current juncture and reinforce the point that industrial policy needs to resort to a multiplicity of instruments in order to address the challenges of structural transformation.

A recurring theme in the *Outlook* is the need for European public goods, much explored by P. Guerrieri and P. C. Padoan (Chapter 8). They focus on the role of economic security in European industrial policy and explore the vulnerabilities and strengths of the EU's industrial and technological strategies, emphasizing the need for deeper European integration and more robust governance to meet these challenges, which require stronger EU-level governance and financial resources for European public goods. A more integrated European defence is obviously another European public good; in Chapter 9, A. Cepparulo and P. Pasimeni examine the significant shift in European security since 2022, characterized by increased and more integrated defence spending. Using new data, the authors analyse the composition and evolution of defence spending in the EU, as well as the distribution of responsibilities across the multi-level governance system. The aim of the authors is to explore how the institutional evolution of EU defence policy is striving to achieve greater convergence of foreign policy objectives and potentially concentrate defence spending at the supranational level. Chapters 10 and 11 focus on two current weaknesses of the European economy. D. Guarascio and A. Simonazzi in Chapter 10 provide an assessment of the vulnerability of the automotive industry. The authors then assess whether the German development model remains viable and outline what might be the essential elements for an effective European industrial policy for sustainable mobility.

Chapter 11 by S. Barbier and H. von Glasenapp attempts to delineate the challenges of the financial framework for the next long-term EU budget. To accelerate the EU's transformation, the authors advocate for mixed public and private financing, a recommendation that also emerges from the Draghi report. The European budget will have to rely on four pillars: prioritize and plan, activate expenditure, decentralize implementation, and strengthen steering. It is on this basis that Europe will be able to finance its investment needs and achieve the structural transformation necessary to maintain and develop its long-term competitiveness within the framework of a new European Competitiveness Pact.

As with the previous instalments, *Investing in the Structural Transformation: 2024 European Public Investment Outlook* includes a first part that details the challenges for public investment and industrial policy in Europe and in its largest countries followed by in-depth country reports for the EU's four largest economies (France, Germany, Italy, and Spain). In Chapter 1, A. Brasili et al. note that while public investment has increased in recent years, there is a need for better coordination and coherence in three key areas: European Public Goods (EPGs), national policy coordination, and funding in the current global context of strained multilateralism and globalization due to constantly shifting geopolitical developments, climate change, the COVID-19 pandemic, energy crises, and the demand for strategic autonomy.

Individual countries face specific challenges, such as import dependency and technological backwardness, which require tailored solutions. Chapter 2, by V. Charlet, M. Plane, and F. Saraceno first traces the long-term evolution of public investment in France, noting how, while comparatively high with respect to other advanced economies, the public capital stock and the general government net wealth have been steadily decreasing since the crisis of 2008. After the COVID-19 shock, despite the 2021 "Plan de Relance" of the 2022 "Build the France of 2030" program, public investment remained surprisingly flat. The chapter then shows how the objectives of French industrial policies have evolved in the recent past. The Lisbon strategy was centred on boosting productivity through innovation and climbing the value-added ladder. The response to the crisis of 2008 marks a first change, with a strong emphasis on price competitiveness and cost reduction (mostly through tax reductions for corporations). Since the early days of the pandemic, then, the notion of "industrial sovereignty" has very quickly eclipsed that of competitiveness, with policies aimed at reindustrialization, especially in strategic sectors. The chapter concludes that these frequent changes signal an excessive short-termism of French policy makers, incompatible with managing long-term structural transformation.

In Chapter 3, K. Rietzler and A. Watt, describe the challenges for Germany caused by a persistent underfunding of public investment. The grim scenario has been exacerbated by the Federal Constitutional Court's ruling declaring unconstitutional the transfer of unused pandemic-related funds to the Climate and Transformation Fund (KTF), which is already underfunded. The renewed application of the debt brake in 2023 has further increased fiscal constraints, risking Germany's ability to meet critical infrastructure and climate transformation needs.

Chapter 4, by G. Barbieri, F. Cerniglia, and F. Mosconi, shows how for a country like Italy—the EU's second largest manufacturer with a strong export vocation—the European perspective is the natural framework for shaping industrial policy. The authors attempt to illustrate what (and if) an industrial policy direction can be traced in the Italian National Recovery and Resilience Plan (NRRP), looking at the so-called "Mission 1" (i.e., Competitiveness) and "Mission4" (i.e., Education and Research). This includes also the strengthening (with investments and reforms) of the Special Economic Zones (SEZs) established in 2017.

Chapter 5 by I. Álvarez and Jorge Uxó provides an assessment of the overall public investment trends for Spain, showing that the COVID-19 pandemic marked a significant shift, with renewed fiscal stimulus and Next Generation EU funds enabling an industrial transformation strategy focused on key sectors with high potential and multiplier effects.

The 2024 *European Public Investment Outlook* examines the crucial need for a robust European industrial policy that effectively addresses pressing challenges such as the green transition, economic security, and the imperative to invest in key strategic sectors, including defence and the automotive industry. This issue of the *Outlook* embraces a multidimensional definition of industrial policy, and advocates for public investment to be a key component of such a structural strategy to build a modern and resilient European Union economy. The chapter authors highlight the need for this new approach to industrial policy to be tailored to an evolving global context. This includes effectively addressing climate change, geopolitical instability, and changing societal needs.

All issues of the *Outlook* emphasize the critical need for improved coordination, effective policies, and addressing challenges such as economic vulnerabilities, defence, and sustainable mobility. A robust EU industrial policy is essential for sustainable growth, economic security, and recovery.

Moreover, *Investing in the Structural Transformation* links with the 2023 issue of the *Outlook* (Cerniglia et al. 2023), dedicated to the constraints posed by high public debt, by offering some proposals on sustaining structural investment financing beyond the year 2027. It further underscores the urgent need for a coordinated, effective, and sustainable approach to public investment and industrial policy in Europe to ensure long-term prosperity and address the complexities of the twenty-first century.

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