Event Report

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EUROPEAN GROWTH AND JOBS IN 2007

Policy Dialogue - 15 December 2006

Summary

Europe is beginning to exhibit positive signs of economic growth, with low inflation, unemployment at its lowest level for seven years and an increase in productivity. This has helped it to "rebalance" its position *vis-à-vis* the United States, speakers told a joint EPC-Hanns-Seidel-Stiftung Policy Dialogue. However, the situation is still "fragile" in several of Europe's major economies, and further measures are needed to increase worker mobility and employment flexibility.

Full Report

Jean-Philippe Cotis, Chief Economist at the Organisation for Economic Co-operation and Development (OECD), began by explaining that one needed to take the US slowdown into account when assessing the health of the world economy. The OECD believed that the slowdown had been a "positive" sign that world growth was being "rebalanced" between the US and the EU.

The American downturn followed a period of overheating in its economy and an imbalance between internal and export demand, but the OECD is forecasting a return to economic growth and price stability in the US in 2007.

In the other key economies - the euro zone and Japan - business confidence remains high, as the former has seen continued recovery driven by strengthening domestic demand, while the latter has experienced a slow recovery from its recent recession. However, said Mr Cotis, these positive trends in the advanced economies could not match the growth rates of 10% in China, 8% in India and 6% in Russia.

Given that demand is a key element of economic growth, there is still a risk that demand might fall. In the euro zone, there has been a short-term downturn in consumer demand, but the situation remains positive as Europeans have a high level of personal savings which could stimulate consumer spending.

In Japan, there is a risk that any potential reduction in export demand might not be sufficiently compensated for by household demand, while in the US, the risk of high aggregate demand means that, for the first time, there is a risk that the US deficit will not stabilise.

Looking at inflation rates, the OECD forecasts that the US will experience moderate inflation in 2008 and, with the loosening of monetary policy, interest rates will remain stable. In the euro zone, inflation will stabilise at 2% and there will be a moderate tightening of monetary policy in the next two years, although this will depend on whether recovery continues as expected.

As for the potential impact of labour costs on world growth, the OECD Chief Economist said these had stabilised in the euro zone and the US, and he did not foresee any further changes.

He concluded that while there is little fiscal consolidation in sight, the “good news” was that strong tax receipts are driving growth, and fiscal policies are likely to be “more prudent than in the past”.

The euro zone is unlikely to repeat its “big mistakes” of the 1990s, said Mr Cotis, and he hoped that European countries would use the good times to make progress in cutting deficits.

Europe’s economy - better than forecast

Klaus Regling, Director-General of DG Economic and Financial Affairs**,** European Commission, said that the EU’s Annual Progress Report showed that the euro zone and the EU-25 had seen more growth than forecast, with economic improvement driven by domestic demand (“desaving”).

Inflation is down to 2% and public finances have steadily improved, as governments have used the good times to consolidate their position, with euro-zone deficits at 2%, compared to 3% in the US and 5% in Japan. Unemployment is at its lowest rate for seven years at 7.7%, structural unemployment has been reduced and productivity has increased.

However, there is still a risk that higher oil prices, a slowdown in the world economy or a “disorderly correction of global imbalances” might reduce the positive future picture, although Mr Regling said there were “good reasons” not to be worried.

The Director-General explained that, following its initial slow progress, the Lisbon Strategy had been relaunched in 2005, with an emphasis on Member States’ ownership of the strategy and greater stakeholder participation and government leadership in national economic and social reforms.

The new strategy is working, he said. Economic growth picked up significantly in 2006, with structural improvements in the labour market and the partnership approach delivering results. There has also been good progress on research and development and innovation, and Member States have reinforced their fiscal sustainability, keeping spending below the 3% limit.

However, they need to introduce further measures to make pensions more sustainable, make their product markets more competitive and tackle labour-market inflexibility.

The need to remove labour-market inflexibilities

Göran Hultin, EU Affairs Adviser, Manpower, said the Manpower Employment Outlook Survey of employees in 27 countries gave a positive assessment, with employers expecting to add to their workforce in 2007. This trend would be more pronounced in America and Asia than in Europe - which Manpower believes reflects European labour- market inflexibilities.

Mr Hultin described the trends across Europe. In the UK, all sectors are "upbeat" about their prospects, predicting an increase in long-term, permanent employment and a reduction in short-term jobs.

The German employment outlook has been improving steadily since 2003, although it remains "fragile" despite positive labour-market reforms and company reorganisation and rationalisation, because of a "wait and see" approach among employers and workers' unwillingness to move around.

Spain's employment outlook is fairly strong, with unemployment at its lowest for 15 years, and 90% of employers planning to increase staff and only 6% planning a reduction. However, the situation is not sustainable with so many new employees on short-term contracts.

In France, the fragile employment outlook is likely to continue, with unemployment levels of 9-10%. Nevertheless, productivity and business efficiency has enabled French companies to compete well on the international stage.

In Italy, all sectors are losing confidence and only 20% of employers plan to change their employment strategies. The future situation hinges on how the new government approaches the need for a more dynamic labour market, said Mr Hultin.

Overall, he concluded, the net employment outlook is positive in both the larger economies and the smaller European countries.

Discussion

Asked about the differences in countries' growth rates, Mr Regling said that in the euro zone, these differences reflected differences in population growth - for example, Ireland and Spain have the strongest growth rates and the strongest population growth. As for India and China, they are going through a "catching up" process, with their high growth rates resulting from the fact that they started from a lower base rate.

Questioned on the impact of migration on economic growth, Mr Cotis said immigration had had a positive impact on OECD economies, but measures were needed to ensure that second-generation immigrants did not suffer from the same handicaps as first-generation migrants. Mr Hultin pointed out that 2006 had been the European Year of Workers' Mobility, and said he wished that the labour force was more mobile so it could fill the emerging skills gaps more effectively.

Pressed about the failure of growth forecasts to internalise the costs of environmental damage, as the UK's *Stern Review on the Economics of Climate Change* had shown, Mr Regling responded that the EU was very concerned about environmental risks and had taken steps to address these. It had doubled its energy efficiency over the last 30 years, and energy and climate change would be high on the German Presidency's agenda.

Mr Cotis said the OECD also supported the *Stern Report*, and agreed on the need to start work on a post-Kyoto world, getting the big players - particularly the US and the large Asian economies - to join in the global effort.

Questioned about the need to turn round the “basket cases” of France, Germany and Italy, Mr Regling disagreed that any of these were in fact “basket cases”. Germany was now competitive and had adjusted after the shock of unification, while France had notched up high growth rates over the past few years and reformed its pensions system. However, Italy still had problems in being competitive.

Mr Cotis agreed that France’s macro economic performance was not bad, but said it still retained a “dual labour market” which hindered equal access to jobs, while Italy had wasted the benefits of monetary union, spending the “windfall” on public expenditure rather than consolidating the deficit or reducing inflation. Mr Hultin believed that these countries should focus on policies that encouraged employers to create jobs.

Asked about other countries copying the Danish system of flexicurity to boost growth, Mr Cotis pointed out that Denmark had based flexicurity on its existing employment and social system.

While Mr Regling supported the Danish system, he did not believe it could be transferred to all Member States because, for example, workers have different attitudes - in Denmark, they change jobs on average every three years, while in Germany they only expect to do so every ten years. Mr Hultin also supported flexicurity, pointing to research which shows that workers feel more secure knowing that there are always jobs available than by having job security *per se*.

Asked whether global inflation would return, Mr Cotis believed that although globalisation had reduced inflation, it would not disappear, while Mr Regling predicted that it would reoccur after the impact of workers’ entering the labour market in India and China had declined.