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## MINUTES

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## **SESSION N°1: THE ECONOMIC OUTLOOK AND THE BROAD ECONOMIC POLICY GUIDELINES**

*(by Filip Keereman)*

Commissioner for Economic and Financial Affairs **Pedro Solbes** opened the fourth Brussels Economic Forum by reminding its main purpose which is to stimulate the economic policy debate at the EU level. Four themes were on the agenda : (i) Economic Outlook and Broad Economic Policy Guidelines, (ii) Globalisation, (iii) the Convention and (iv) Ageing.

With respect to economic policy issues in the Convention, Commissioner Solbes took the opportunity to convey the message that the decision-making process within the euro area should be facilitated and that adequate representation of the euro area should be ensured. In his speech he devoted also some attention to the Stability and Growth Pact and defended the Commission approach as outlined in the November 2002 Communication.

**Klaus Regling** (Director General, Directorate-General "Economic and Financial Affairs") presented the Commission Forecasts and the Broad Economic Policy Guidelines (BEPGs). The global recovery is hesitant and unbalanced, he said. Economic prospects in the EU were bleak in the first half of this year, and potential growth would be reached only in 2004. Unemployment increases, inflation is slow to decline and government deficits widen. Despite weakness in their main trading partner, the outlook for Candidate Countries remains solid. He then introduced the Commission's Recommendation for the BEPGs for the 2003-2005 period. The BEPGs outline the contribution of economic policies to the attainment of the Lisbon strategic goal. To this end, they recommend action to ensure growth and stability oriented macroeconomic policies, to accelerate economic reform to raise Europe's growth potential and to strengthen sustainability. Particular attention attaches to the need to use human resources better, both by getting more people into work and by raising their productivity. With the policy strategy set for the coming three years, the focus must now shift towards implementation.

**John Lipsky** (Chief Economist, JP Morgan) argued that there was no problem with household spending in the US. Rather profits were squeezed leading to corporate balance sheet problems, but these have been addressed and investment was picking up. The EU has similar balance sheet problems, but the adjustment is much slower, because firms issue less marketable debt and hence face less pressure to adjust. He draw the attention to a two-speed globalisation: there is stronger integration between the US and Asia (the high-growth countries), while the low-growth countries are left behind (which include the EU). Finally, in his overall optimistic view on the US, he dispelled the view that the current account deficit was the result of overspending in the US.

**William White** (Head of Monetary and Economic Department, Bank for International Settlements) analysed if Japanese-style deflation could also occur in Europe and the US. To that end he analysed the pathology of bubbles and if there were financial headwinds on the recovery. On the one hand, financial resilience increased because risks were shifted outside the banking system and because the capital ratio strengthened. On the other hand, there are concerns related to housing prices, household indebtedness and increased corporate yield spreads. Shares are mostly held by households in the US, while in the EU institutional investors are important share holders . From a systemic point of view it is unclear which shareholdership structure has to be preferred. The distribution of risks is best assured in the US, but financial institutions should be better in risk management, pleading in favour of the EU system. He concluded that deflation is unlikely.

**Bart van Ark** (Professor, University of Groningen) analysed the growing productivity gap between the US and the EU in the second half of the nineties. )

During the **open debate** several questions on economic policy were addressed to the European Commission. The pro-cyclical nature of the Excessive Deficit Procedure at the present downturn and the stability of the single currency area, which its long-term advantages, were debated. Monetary policy was considered too tight and inflation differentials were seen as problematic, opinions not shared by everybody.

Replying to questions on the prospective increase in unemployment and whether an analysis had been made of it, Klaus Regling replied that there is clear evidence that significant progress has already been achieved as a result of labour market reforms and that the Commission's views on how to address the issue are clearly spelled out in both the general and the country-specific part of the BEPGs. Replying to questions as to whether the 2010 agenda is realistic, particularly in relation to the apparent difficulty to pursue labour market reform in Germany, Klaus Regling conceded that the targets are ambitious and that probably the implications of demographics have been underestimated in setting them. He also stressed that the Commission was not satisfied with the record on implementation achieved so far; important delivery gaps remain. As to the specific case of Germany, he replied that the recently announced measures, if implemented, would certainly help to improve the situation. Finally, on inflation differences within the euro area, he replied that a ECB study suggested that the variation in inflation rates within the euro area was comparable to that one observed in the US. Furthermore, inflation differences allow for necessary adjustments in real effective exchange rates to underpin the proper functioning of EMU. Differences in inflation may, however, not be warranted when due to remaining rigidities in product or labour markets or automatic wage indexation mechanisms.