

Short minutes of the Brussels Economic Forum 2005

Commissioner Joaquín Almunia opened the sixth Brussels Economic Forum by commenting on the European Union's disappointing economic performance, whilst highlighting the dynamic performance of some Member States and the challenge of raising the European Union's growth potential. He focussed on the strengthening of the Stability and Growth Pact (SGP), the renewed Lisbon Strategy and the role of the Broad Economic Policy Guidelines (BEPGs) in this strategy.

First Session:

The economic outlook and the Broad Economic Policy Guidelines

Gideon Rachman, as chairman, placed the theme of this session in context by referring to the apparent paradox of buoyant world growth in excess of 5% in 2004 combined with important global imbalances.

In his presentation on "*The economic situation in the spring of 2005: policies for sustained growth*", Klaus Regling considered the economic challenges facing the euro area and the EU in both the short term and the long term. In his discussion of the risks associated with the Commission's spring economic forecasts released on 4 April [http://europa.eu.int/comm/economy_finance/publications/european_economy/forecasts_en.htm], he compared the economic performance of the current euro-area recovery to past cycles and highlighted growth divergences across the economies of the EU. Against this background, he referred to the Integrated Guidelines for growth and jobs recently adopted by the Commission and outlined the underlying economic rationale for the relaunched Lisbon Strategy with particular emphasis on the reforms needed in the EU to meet the challenges posed by ageing populations, increased globalisation and technological change.

Dominique Strauss-Kahn ("*Economic Governance and the Revision of the Stability and Growth Pact*") focused on the revision of the SGP and what would be needed to make it work. In his view, the reform of the Pact has provided a positive illustration of the spirit of the European Constitution, in that it has clarified the implementation of rules that might otherwise be seen as too schematic and has introduced a more important role for political initiatives. He argued that the strengthened Pact was a better one, not due to its "exceptions" but because it has allowed for assessment of the situations in individual member States and has brought the concept of debt sustainability back into the limelight. He called for self-discipline on the part of national political authorities, warning about the strong detrimental impact that would ensue if political authorities were to use the extra leverage granted to them solely for national political purposes, instead of putting European interests first. Finally, he stressed that the euro made long-term sense only if it was accompanied by a continuation of the process of European political integration. He pointed out that there was no historical example of a lasting currency shared by independent states without advanced political integration.

In considering the factors explaining the growth differential between Europe and the US over the past few decades, Phillip Hildebrand ("*The EU economic recovery: why is it so slow?*") mentioned measurement issues favouring a higher growth rate in the US, cyclical factors and a higher growth rate of the labour input in the US in the period 1980-1995. He noted that since the mid-90s, differences in productivity growth have become an important explanatory variable. The EU has been slower to reap the productivity-enhancing benefits of ICT in a range of ICT-using industries. A sudden jump in productivity might well materialise in the EU. He maintained that, since expansionary monetary and fiscal policy is of no use in the

longer term, raising productivity growth through structural reform should be considered the key to the prosperity of future generations in Europe. In this context, he emphasised that for labour market reforms to be successful, productivity gains should be reflected in product prices so as to maintain consumer confidence by compensating for lower wages.

Mario Draghi (*“Exchange rates: where are the markets taking us?”*) distinguished between the short-term, when speculative flows can lead to exchange rate fluctuations, and the medium-term, when economic fundamentals play a more important role. In his view, a desire to diversify risk would reduce the willingness of Asian central banks to continue to hold USD-denominated assets. Commenting on the sustainability of the US current account deficit, he noted that existing FDI and medium-term portfolio flows could only support a deficit of 3% of GDP. While acknowledging that the potential for further adjustment of the USD exchange rate did not favour the economies of the EU, he pointed out that the euro area as an economic aggregate was much less sensitive to shocks from the outside than its individual member states had been in the past. He suggested that the strength of the euro might be considered beneficial to the euro area if it were to lead to further structural reforms, similar to the US experience with reforms in the 1980s.

Issues raised in the subsequent discussion included: the credibility of the strengthened Stability and Growth Pact and its application to Italy as a test case; whether productivity was already on the rise in Europe this year; and the likelihood of implementation of National Reform Programmes at the Member State level under the renewed Lisbon Strategy. On the strengthened SGP, Commissioner Almunia insisted that there had been no change in the substance of the SGP. More specifically, only the details and deadlines involved had been altered in order to support the better functioning of EMU. He noted that the first two cases to be assessed under the strengthened Pact would be those of Italy and Portugal, adding that reports would be drawn up under Article 104.3 taking into account all relevant factors, including an emphasis on debt dynamics. Mario Draghi pointed out that markets would rate Member States' sovereign risk differently if they considered that the new rules were not taken seriously. He warned that when markets react late, they often do so with a vengeance. On the observed rise in productivity in 2004, Klaus Regling replied that one should not overstate this development. He acknowledged that the Commission's spring forecast projected in productivity in the EU in 2005-06 but only at half the corresponding US rate. On the Lisbon Strategy, Commissioner Almunia stressed that increasing the degree of national ownership – by requiring involvement of the relevant national players (parliament, social partners, public, etc.) – was a key new element, together with the simplification of the objectives of the Strategy. These new elements would increase the credibility of the Strategy as well as the likelihood that required measures would be implemented and that the goals of the Strategy achieved.