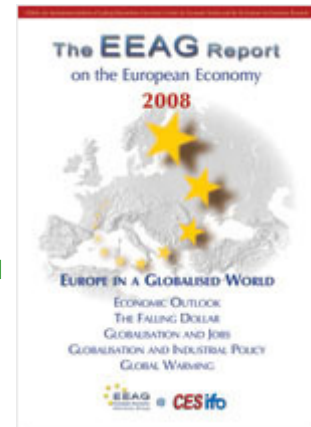


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## **Clouds in the US but no Recession in Europe; Globalisation can create European jobs at greater rate than it destroys them**

Despite the subprime-triggered financial crisis in the US, the European economy will continue to grow this year, but with less dynamism, according to the European Economic Advisory Group (EEAG) at CESifo, a unit of the Ifo Economics Institute, at the University of Munich.

**The seventh [Report on the European Economy](#) (scroll down for individual chapter links) by the European Economic Advisory Group (EEAG) was launched in Brussels today and in London and Berlin on Feb 28th.**



The seven European economists comprising the non-partisan advisory group, which includes Prof. Jan-Egbert Sturm of the KOF Swiss Economic Institute, released their yearly report today in Brussels. In it, they forecast a GDP growth of 1.8 percent for the Eurozone, with a slightly higher figure of 2.1 percent for the EU27. This slowdown, they assert, would bring Europe back from a period of stormy growth to one that better reflects its potential.

The factors driving European growth down are the appreciation of the euro against the dollar and the consequent reduction in US imports. Investment growth in Europe will decelerate, but employment will continue to improve as a result of the still-positive output gap. Private consumption, in the face of creeping inflation and moderate wage increases, will grow at about the same rate as in 2007. During the first months of 2008, inflation will exceed the 2-percent goal set by the European Central Bank; according to the EEAG experts, it will not come down to that level until 2009.

As regards the US economy, EEAG forecasts growth to fall to 1.7% in 2008. That it remains positive is largely attributable to an overhang from 2007. The economic climate index for the US has slipped below that observed after the Sept. 11 terrorist attacks. Still, the substantial fiscal stimulus programme approved recently, coupled with low interest rates, will enable the US economy to just scrape by without actually falling into a recession. The group says any prediction regarding performance of the US economy is risky: on the one hand, the cheap dollar will boost exports; on the other, the full impact of the declining house prices and the subprime mortgage crisis is still unclear.

The Asian economies, in turn, proved remarkably resilient in 2007, posting enviable growth rates that seemed impervious to the financial jitters emanating from the US. Its banking sector appeared unaffected, with bank credit supply showing healthy levels and with a stable spread between company and government bonds. Still, the slowdown in US imports has caused exports from the region to lose momentum. Luckily, domestic demand in the Asian economies has gradually turned into the main engine of growth and it remains strong. It will probably continue to buffer some of the slowdown in the world economy.

Back to Europe, although banks report that recent tensions are causing a tightening of credit, interest rates for non-financial companies and households loans in Europe do not appear to have been affected by much. Neither have credit volumes so far. Thanks to robust growth in other parts of the world economy and the interventions of central banks worldwide, the repercussions

from the real-estate crisis in the US are likely to be much less severe than what has been heretofore assumed.

### **Globalisation and Jobs - No Reason to Introduce Minimum Wages**

In the opinion of the EEAG experts, the discussion on globalisation is often too one-sided, concentrating solely on its negative impacts. Job losses spring to mind: Low-wage foreigners replace the locals who are then pushed into unemployment. **But this will continue to occur only if the labour markets remain rigid.** The EEAG scholars stress that these rigidities will also be affected by globalisation, forcing them to relax and permit downward wage adjustments. Once that happens, globalisation will start to create jobs at a greater rate than it destroys them.

**Still, income will shift partly from unskilled employment to capital. In other words, there will be losers, but the role of governments should be to compensate those disadvantaged by globalisation. Setting up minimum wages, the EEAG experts stress, is not the way to do it. Helping them to retrain and providing wage supplements is the way to go.**

### **Globalisation and Industrial Policy**

In some quarters, industrial policy appears to be the weapon of choice to shield European industries from the competition posed by globalisation. Talk of "*national champions*" is fairly ubiquitous, its populist overtones usually swamping the corresponding economic facts.

The EEAG experts stress that the long-term costs of propping up national champions against foreign competitors far outweigh the benefits. The real challenge is to hone such industries in order to make them more competitive in the global arena. To this end, industrial policy should be horizontal rather than sector-based, and located mainly at the regional and EU level. It should be cut back at the national level.

Chapter 5 addresses one of the most long-term issues for mankind: global warming. The chapter points out that most existing analyses have neglected the supply side. Without a proper analysis of supply-side effects, demand-reducing measures, which are generally regarded as self-evident solutions (such as emission permits, taxes on fossil fuels and the subsidisation of alternative energy sources) risk not only being ineffective, but even counterproductive. Any reduction in oil consumption by "*green*" countries, for instance, would depress oil prices and provide an incentive to other countries to take up the slack. In global terms, CO<sub>2</sub> output would remain unchanged. Unless every country joins up in a sort of global Kyoto Protocol, consumption-reduction measures by a few will have negligible effects in terms of emissions. In the end, the amount of CO<sub>2</sub> that gets pumped into the atmosphere depends on how much fossil fuel is pumped out of the underground deposits.

Getting the producers on board any initiative to reduce global warming is, thus, just as important as reducing consumption itself..

**\* The EEAG Group is comprised of Lars Calmfors (Stockholm University, chairman), Gilles Saint-Paul (University of Toulouse, vice-chairman), Giancarlo Corsetti (European University Institute, Florence), Michael Devereux (University of Oxford), Jan-Egbert Sturm (KOF Swiss Economic Institute, ETH Zurich), Xavier Vives (IESE Business School), and Hans-Werner Sinn (Ifo Institute for Economic Research and University of Munich).**