Eurozone Growth: Stagnation or Recovery?

By Antonio Fatas , INSEAD Professor of Economics

A battle between pessimism and optimism is being waged about whether Europe is stuck in a quagmire or marching back to growth. Both sides have strong arguments but they also agree on what has to be done.

Euro area growth rates continue to be disappointing. Despite all the excitement that the launch of a new currency in 1999 brought to Europe, since 2007 we have witnessed a double-dip recession and a performance that is substantially lower than that of the United States.

We have now been talking about a recovery but the optimism has become transitory leading to a new wave of pessimism and crisis. The earlier signs of recovery back in 2009 and 2010 were crushed by the sovereign-debt crisis in 2011 and 2012. We started 2014 with a certain degree of cautious optimism but will this also prove to be transitory or is it for real this time?

As part of the recent **INSEAD Global Business Leaders Conference** in Lisbon, Portugal, we put together a panel of experts that provided their perspective on the current state of the euro economy.

The views of the panellists were mixed. While they all recognised that the worst was behind us, there are still many challenges ahead and questions that have not been answered about what needs to be done.

Policy priorities

Charles Wyplosz, Professor of International Economics at the Graduate Institute of Geneva, focused on the policy mistakes that have undermined the euro recovery. “The disaster that the EU commission created by pushing everyone into austerity… will not help growth”. He expressed a more positive view on some of the structural aspects of the euro experiment such as one monetary policy but argued that Europe shouldn’t harmonise all of its laws and taxation arrangements.

“We should let countries compete with each other, develop different packages of taxation and law and let some corporations go here for some reasons and there for other reasons, it doesn’t have to converge,” he said.

He added that compared to similar historical or current experiments (such as the U.S.), Europe needs time to integrate in the way the United States has done, adding that the criticism about Europe not moving in this direction is not a fair one.

Picking up the thread on the recent trend of “inversion” Roch Doliveux (INSEAD MBA ’81), the CEO of UCB, a biopharmaceutical company added “in my industry right now, every U.S. company is trying to make a deal to go and reside in Europe. Fine let’s attract them. Let’s not kill that through

European bureaucracy."

Doliveux also provided a perspective on the state of industry and innovation in Europe. His biggest concern was in the lack of access to capital and the barriers to investment, business creation and innovation in Europe. Using an example of the biotech industry in Belgium, where half of Europe's biotech market capitalisation is represented, this has been a success story mainly because of the backing by family firms that do not rely as much as public corporations on external funding.

Financing growth

Access to capital was an issue that united all panelists. Andreas Höfert, Chief Economist, Wealth Management and Regional Chief Investment Officer, Europe at UBS, expressed concerns that Europe has not moved as fast as the U.S. when it comes to the cleaning of balance sheets of financial institutions. And it is always a challenge because we want banks "to bring their balance sheet in order but also lend more money" and these are contradictory objectives.

As banks dominate the provision of credit in the euro area unlike the U.S., where companies raise much of their funding on the bond markets, concerns remain that not enough is being done to improve lending. Wyplosz added, "In Europe, we had no clean up and now it's happening with the stress tests four years down the road, so it's no surprise that the banks are not lending." He felt that there would be no safe recovery until this was addressed.

Höfert concurred that the current European Central Bank stress tests on the banking sector, are proving to be another brake on lending.

The way forward

Doliveux put green technology and healthcare at the top of his list of sectors that need more policy attention, from encouraging overseas investment to fostering talent in the sciences.

Wyplosz emphasised the need for countries to learn from one another. We have some very good examples in Europe of governments that are efficient (even if their size is large, such as Sweden), he said. He emphasised the same for labour markets and regulations, where there is room to share best practices. Höfert also agreed on this view and he stressed the need to move faster towards a more integrated Europe.

At the end, the interesting debate among the panellists and the views of the audience provided, once again, a mixture of optimism about all that Europe can provide to the global economy and pessimism resulting from all of the missed opportunities that we have witnessed through a combination of policy mistakes and lack of reforms and integration.

Reforms, however, topped the wish list of policy priorities for the panelists. Höfert, pointed to Germany’s successful turnaround from the “sick man of Europe” 12 years ago as an example of the possibilities. Wyplosz agreed, pointing to Southern Europe that is in particular need of labour market, government and tax reforms.

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