

Interview with Dr. Daniel Gros, Director of the Centre for European Policy Studies

Prospects for the EU Economy & Economic Policy

By Japan SPOTLIGHT

The Centre for European Policy Studies (CEPS) is a Brussels-based think tank established in 1983. It has been dealing primarily with issues related to European integration and today undertakes research on solutions to the challenges facing Europe. *Japan SPOTLIGHT* was privileged to have an interview with CEPS director Dr. Daniel Gros, a German economist and expert on the economy and finance of the European Union.

(Interviewed on Sept. 22, 2017)

Introduction

JS: First of all, could you give a brief background to your research activities and interests?

Gros: I received a Ph.D. from the University of Chicago where I concentrated on finance and international trade. Then I worked at the IMF for a while where I mainly conducted research on exchange rates. For almost the last three decades I have been back in Europe where my research has focused on monetary and financial integration in Europe; first on the setting up of the monetary union at the ECB and more recently I have increasingly focused on the link between the monetary union and financial markets.



Dr. Daniel Gros, Director of the Centre for European Policy Studies

Gros: Indeed, it can continue for another couple of years as the labor market improves, in the sense that — as with Japan — the labor force participation rate is increasing with more people coming into the labor market, so unemployment is being reduced slowly but steadily. The recovery can also continue because it is not fuelled by a fiscal expansion; fiscal policy is neutral and monetary policy is expansionary but I think it does not have a strong impact any more on the economy. Therefore, it is all very solid and there is no reason why it should not continue.

JS: However, some say there is a disparity among the member economies in the EU. Would you agree with this, or is it the case that all the economies are in good shape?

Assessment of Current State of EU Economy

JS: In terms of the current state of the EU economy, the media suggest that it is enjoying a stable recovery, but would you concur with this view?

Gros: That is right, my view is that the recovery has been pretty stable for three years now; on a per capita basis, it has been almost stronger than that of the United States, and the European labor market has been improving trend-wise every year for the last 20 years. So there is a strong underlying strength in the European economy which is a not very high growth rate but moderate and very consistent.

JS: Will this recovery likely continue for another couple of years or so?

Gros: All the countries are now actually expanding at the same pace; it is like a convoy — all ships are moving at the same speed but not everybody is in the same position. There are some risks to this stable economic growth but they are mainly political, such as the risks posed by the Euroskeptic party in Italy.

Assessment of EU Monetary & Fiscal Policy

JS: Turning to the US, with the Federal Reserve Board poised to raise the interest rate, how do you think this will affect the global economy?

Gros: This continuation of the normalization of policy in the US has been widely anticipated so I don't think it will constitute any new departure and for the time being it will be quite relaxed.

JS: What about fiscal policy? Up until a few years ago, the EU seemed to be very conservative about expansionary fiscal policy but today it seems to be somewhat different. What do you think about the idea that the EU and the US seem ready to accept expansionary fiscal policy?

Gros: I think the EU rules will continue for further austerity in countries that still have large deficits, like France, Italy and Spain. Unfortunately, we have rules in place but no strong will to enforce them so the most likely scenario is one where fiscal policy in Europe will show very little change. The deficit is now already at a low level on average and so it is possible to safely continue with the current level of deficit; I don't think any major changes are imminent.

JS: What do you think about Germany's current account surplus in terms of it posing a threat to the global economy?

Gros: The German current account surplus is hardly new and has been around for nearly a decade. So, I don't think it constitutes a threat to the global economy. You could argue that the current account surplus means that Germany takes away demand from other countries, but that is only important if the rest of the world has a huge output gap and if there is lots of unemployment in the rest of the world. But there is no longer and therefore I would say that if the Germans want to save too much then it could be a mistake but it would be their mistake and would not pose a threat to the global economy.

Risks to EU Economic Growth

JS: What do you consider to be potential geopolitical risks to EU economic growth?

Gros: I think that the main risk is not geopolitical, but rather "local political". Local political in the sense that in Italy there are some somewhat unhinged parties and if they have a majority in parliament then Italy might encounter some problems. Locally in Spain we have the same with the independence movement in Catalonia, which is after all the richest part of Spain; the situation could get out of hand and the Spanish government might feel it has to send more money to Catalonia, which would in turn cause the Spanish deficit to increase. These are the kinds of problems that I foresee rather than geopolitical risks.

JS: Could increasing immigration in the EU provoke populism?

Gros: There could be populism caused by immigration policies but I do not think that it would greatly affect the economy, and I do not think that migration will resume on a large scale. This problem has not been resolved but it will remain manageable for a few years.

US Economic Policy's Possible Impact

JS: How do you see President Donald Trump's policies impacting the EU economy?

Gros: Well, I don't see any coherent economic policy from President Trump. The next budget might be the same as the last one, and on trade so far he has talked a lot but done nothing so I don't foresee any major impact.

JS: In the US they started talking about tax reform and this seems to include some policies to enhance the competitiveness of US industries. Do you think this would impact the competitiveness of EU industries or not?

Gros: If the US were to go ahead with such reforms it would affect Europe but all indications are that this notion of having a broader tax adjustment will not materialize and therefore I think we can be quite relaxed.

JS: What about US trade policies or environmental politics? Trump has announced he will withdraw from the TPP and also the Paris Agreement — will this have serious policy implications for the EU economy?

Gros: The withdrawal of the US from the Paris Agreement will actually only become effective in five years so who knows what will happen. It is a political issue in Europe but will have zero implications for the economy. The withdrawal from the TPP might make it more likely that Trump agrees on a Transatlantic Trade and Investment Partnership, but this will take some time to negotiate.

Assessment of EU's Structural Reform

JS: What in your view is the current status and future prospects for structural reform of the EU economy?

Gros: There is very little prospect of deep structural reforms. Structural reforms would have to happen at the national level, and in most countries there is no appetite for deep reforms with the possible exception of France right now with its labor market. Such reforms will come but the question is how deep it will be, and I think we will find this out over the next few months. I expect that in the end there will be reform of the labor market in France, the effects of which we will not see immediately and it will be five or 10 years before this shows up in the data.

JS: There is growing attention in Japan to information technology innovation, perhaps also in Europe. How do you estimate the possible impact of the so-called

Fourth Industrial Revolution on the growth potential of the EU economy?

Gros: There is lots of talk about innovation policy but not much is really done so I do not foresee significant potential in Europe; we have enough well-educated people to take advantage of new technology, but we also have many people in institutions who resist change and that is why we have a problem with innovation in Europe and that will not change. I do not think that the Europeans will encourage innovation; in abstract terms, everybody likes innovation but when it comes to actually making practical changes, people tend towards maintaining the *status quo*.

JS: Do you think that the employment issue is closely related to such a conservative attitude to innovation, given that innovation could reduce employment?

Gros: To some extent this is the case, but actually employment is increasing nicely in Europe. It is not the case in Europe that income distribution is becoming more unequal; in some countries there is more, in some less, so it is very mixed. In Germany, the income gap has increased but the economy is doing well so it's not such a big problem. In Italy the income gap has actually fallen but the economy is doing badly so it is a problem. So as you can see, it is a somewhat complicated picture.

JS: In Japan, labor market reform is sometimes mentioned as a key to reducing the income gap as we have a large number of non-permanent employees who are not well paid and this is identified as the source of the income gap. How about in Europe with regard to the labor market?

Gros: Actually, in Europe we have a similar phenomenon. We have very strong industry that can pay very high wages to very productive people, while the less productive people can either be unemployed or employed at a low wage and the government gives them something on top so that their income is the same as before. This is what we see in Europe, that more people are doing part-time and low-paid jobs but they get something on top from the government and this is better than having these people unemployed and doing nothing.

JS: What do you think about the impact of immigrants upon the employment situation in Europe? And what about the impact of the aging population?

Gros: This impact is very limited because we are a continent of 500 million people; if 1 million come, it doesn't really change anything. The aging population will not likely impact productivity, but the low growth rate of the population of course means that overall GDP will also be limited. Productivity should be maintained amid an aging population but maybe some more openness to change in Europe would be good.

JS: What do you consider to be important to maintain high productivity? Free markets? Free competition? Labor Mobility?

Gros: Europe has pretty free markets, and it enjoys pretty free trade. What is missing is a liberal, open attitude towards change and the adoption of innovation and new technology. We have a low degree of labor mobility in Europe but it has increased lately. Most of the obstacles to labor mobility are not a question of labor market reform but more a willingness of people to change place.

JS: How about the impact of education and human resources development on the labor market and mobility?

Gros: More education means that people are more likely to find a job. More educated people tend to be more mobile and Europe has made big progress in educating its population; the surprise is that this has not led to higher productivity.

JS: What do you think about entrepreneurship and other sources of economic vitality? Do you think that entrepreneurship is strong enough in the EU economy?

Gros: Now entrepreneurship could certainly be stronger, but there is very little that policy can do about it. You cannot increase entrepreneurship through the government; it has to come from the people below. The private sector could have some role to play in this.

JS: What do you think about FinTech's impact on the EU economy?

Gros: So far, FinTech has had very little impact on the financial markets and the European economy. I don't think that it will change in the future; the Europeans are decidedly conservative in their financial dealings.

JS: What do you think about impediments to structural reforms? Could local politics be an impediment to structural reforms of fiscal policy?

Gros: Yes, local politics makes it difficult to maintain tight fiscal policy, but I think we have a near-consensus in Europe that the deficit should not go above 3%, and if possible lower, and therefore I don't think we will have very large deficits.

JS: While Japan has a problem employing its aging populace, it would seem that youth employment is more of an issue in Europe. How could youth unemployment be reduced?

Gros: Youth unemployment is vastly overrated as a problem, because the unemployment rate is calculated as the unemployed relative to those who are actively seeking work, and in many European countries not many youths are looking for a job. Youth unemployment receives a lot of political attention but it is not so significant.

JS: Regarding the question of local politics, the Japanese media seem to think that populism in the EU and US is caused by an income gap. Would you agree?

Gros: No, actually in Europe most of the populist problems are not caused by the income gap, but rather by low productivity growth and even more by immigration; immigration and cultural factors. People feel that somehow their society is changing and that when you walk around in the street you see people with different faces and they feel that somehow the foreigners are not adapting enough to the local culture.

Lack of Global Governance

JS: In the absence of US leadership, what would constitute relevant global governance as regards economic policy?

Gros: I do not think we have had a lot of global governance except under the special circumstances of 2008-9 and I do not expect that we will have a lot of global governance anyway — even without the US leadership — so I do not think a lot will change. The G20 process has not delivered any global governance over the last few years and this is not likely to change significantly.

JS: How about international organizations like the World Bank and OECD — would these function as well as they did in the past?

Gros: Did they work that well in the past? I think what is more important is how actively China becomes integrated in these institutions because its economic might is increasing and the question is, can we run a global economic system where the US is not interested and where China thinks it has no obligations?

JS: In that context, what do you think about the Chinese initiative with the Asian Infrastructure Investment Bank (AIIB)? Is this an attempt to join in global governance?

Gros: Essentially, why should one object to the Chinese using their current account surplus to finance infrastructure elsewhere? I do not think that is a big deal; rather, it is a way for them to consume their excess savings. For China it is not important to govern the rest of the world; they first of all want to become rich.

JS: It seems that the WTO has played a steady role in the past to achieve free trade. Global governance for free trade seems to have worked well at a certain stage but it is not working anymore, and due to President Trump's negative attitude toward free trade, this trend seems to be intensifying. How do you view the WTO's role?

Gros: Yes, the WTO has been very important and played a very important role. In particular, I think that the innovation of the WTO was to have this dispute settlement mechanism; this mechanism still works, I think, but here is the real danger: the US could destroy it. It has not happened yet, but the WTO's dispute settlement mechanism is in danger of being destroyed by Trump, and this is a worrying development.

JS: We have established that the income gap is not the cause of political instability in Europe. So in your opinion what would be the key to further stabilizing politics in Europe?

Gros: I would reiterate that it is not about the income gap but rather about cultural factors, and I think politicians have to give people the feeling that society is in command. Let us take immigration as an example — in Germany people were upset when there was no longer control over the borders, but once you have control over the borders the government can say, “Look, we can determine who is coming and who is not coming and those who are coming have to behave because our police are strong.” This is what people want and this is what governments have to deliver. Having said that, not all governments are able to deliver. The German government is pretty efficient and can deliver, but the Italian government is just not efficient enough to provide this assurance to its populace.

JS: Finally, on the issue of Brexit, this is not just a question of the economy but also of UK politics. The Labour Party should be looking out for the economically marginalized people's interests and opinions, but it seems to have ignored them, and this is often mentioned as one reason for Brexit. Would you agree with this?

Gros: That is part of the explanation; another part is that at the time of the referendum the European economies seemed very weak, and Europe seemed to have an unsolvable immigration problem, so rather than the Labour Party neglecting its support base it was more a case of very bad timing.

JS

Written with the cooperation of Mayu Fukutani who is a freelance translator.