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EUROPEAN REFORMS CONFERENCE – SOME KEY TAKEAWAYS

Berenberg Macro Flash

At the Berenberg Conference on European Reforms on Monday, the speakers covered a broad range of issues. For example, **Alain de Serres** (OECD) explained in detail how the OECD measures reform progress and the key results which, on balance, are somewhat encouraging for Europe. Reforms to promote employment are one reason why employment rates for young people have risen substantially since 2013. **Lúcio Vinhas de Souza** (European Commission) analysed the remaining shortcoming of the euro area framework and presented the menu of options which the Commission has outlined to resolve the issues, including a to-do list for 2017-19. **Klaus Regling** (ESM) highlighted the record of the euro area (more fiscal space than the US, significant rise in the employment rate since 2000) and discussed proposals to strengthen the monetary union (including completion of the banking and the capital markets union, simpler fiscal rules and a small fiscal capacity for macroeconomic stabilisation).

As I cannot do the presentations justice, let me summarise my own impressions instead:

By and large, the Eurozone is on the right track. Beyond a mere cyclical recovery, the region is benefitting from genuine reforms. The doomsayers have been proven wrong. Even the "sceptical journalist", as **John Peet** (The Economist) introduced himself, noted that the euro area is in reasonable shape, adding that this in itself may be an issue because it makes it less likely that Berlin will see a need to shift its position in the future.

While the euro may "not be completely safe" (**John Peet**), virtually all speakers seemed to agree on one point: with perhaps a few modest reforms to come, the Eurozone would be able to cope with a normal recession in, say, 2021, without falling back into a deep new crisis. As one member of the audience put it: that many observers now see Germany's current account surplus as one of the key problems in Europe shows that many other issues have become less pressing.

On **France**, most other speakers would probably not go as far as I do when I proclaim that a reformed France could be heading for a golden decade in the 2020s, outclassing a Germany that is becoming a bit complacent and a UK that has shot itself in the foot with the Brexit vote. But by and large, the detailed discussion of the outlook for French reforms at least did not contradict my views. Prominent French economist **Charles Wyplosz** (The Graduate Institute) called the domestic reforms "mostly good" and noted that they constitute a "historic turning point" which could help to get French unemployment down from 9.8% now to 5-6% by the end of Macron's term in 2022. However, he also drew attention to "warning signals" such as protectionist tendencies and a traditionalist view in Paris of the state "as a strategic player" in economic affairs. This assessment reminds me of my own response to the German "Agenda 2010" back in 2003. I had greeted them with two rather than three cheers as they fell short of the more thorough overhaul of the labour market that free-market economists like me had argued for. Nonetheless, the reforms worked very well. Lesson: in real life, reforms don't need to be perfect.

Italy remains the key concern for the euro area. Unsurprisingly, various speakers noted Italy's high debt level and uncertain political outlook. However, **Riccardo Barbieri Hermitte** (Italian Tesoro) did a great job dispelling the impression that Italy is not doing enough to shape up. Playing the "defence attorney" for Italy, he drew attention to the major pension reform under Monti, which has reduced the projected share of pension expenditure in GDP in the next two decades by 3 ppt of GDP and explained in detail the Renzi labour market reform of 2015. More importantly, he suggested that, after some loss of momentum in 2016, reforms are continuing under the Gentiloni government. As the key issues in the banking system are now under control and the burden of non-performing loans is easing, the economic outlook continues to brighten. After reaching an annualised pace of 1.6% in the last three quarters, chances are that Italian growth may even firm a little further according to our speaker from Rome. After listening to the presentation, I am ready to admit that the risk to our Berenberg forecast for Italian GDP growth of 1.4% in 2017 and 1.2% in 2018 is very much to the upside.

The discussion added a lot to my understanding of France, Italy and the outlook for European reforms. These new insights do not force me to change my big-picture views, though. I expect Macron to succeed and look for a modest set of reforms to the governance structure of the euro area to be agreed next year. These reforms in the euro area will likely entail a permanent head of the Eurogroup called “euro area finance minister” with limited powers, an upgrading of the ESM to a European Monetary Fund and some common pots of money.

- For a detailed exposition of the reform ideas that make sense, see this report.
- For our own assessment of adjustment progress in all 28 EU member countries, see Euro Plus Monitor September 2017 Update „The Next Stage“

Except for a half sentence by one of the other speakers (an Englishman) and myself, nobody mentioned Brexit during the entire one-day conference. More than anything else, this shows that - sadly - the UK plays no major role any more in discussions about the future of Europe.

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