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Global Economic Challenges: Europe and Asia – Summary

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Barry Bosworth holds the Robert V. Roosa Chair in International Economics at the Brookings Institution and is a senior fellow in the Economic Studies and the Global Economy and Development programs there. Donald Kohn is a senior fellow in the Economic Studies Program at the Brookings Institution, former vice chairman of the Federal Reserve, and 40-year veteran of the Federal Reserve System. They discuss the global outlook for Asia and Europe, noting that nearly half of the world's economic growth in the next few years is projected to come from Asia, and that Europe is falling into recession as it tightens fiscal policy, raises taxes, and cuts spending. The lack of political union across the European Union makes it very difficult to address its problems.

Key observations include:

- Overall world economic growth is expected to be just 2.5 percent in 2012, which is historically a very low growth rate. Asia is now the center of world economic activity, as nearly half of growth is expected to come from there.
- Growth is expected to slow in Asia, but will remain strong relative to the advanced economies. China, for example, is projected to grow at 8.4 percent in 2012.
- Asia has more options at its disposal to deal with its worsening economic situation than do the United States or Europe. The U.S. has nearly exhausted its monetary policy options, and its deficit is hampering fiscal policy. China's financial system is far less complex than the United States', and it has high level of government reserves.
- Japan's household savings rate has fallen from very high levels to roughly the same as that in the U.S.

With more of its aging population in retirement, more of its income is used for consumption and not investment. Little or no investment is occurring in Japan and, likewise, its economy is stagnant.

- The European Union's fundamental problem and source of tension is that it is suspended between full monetary and political union and being several independent sovereign states
- The monetary union encouraged economic imbalances in the EU countries largely because the differences in government bond yields prior to the introduction of the Euro collapsed upon its adoption. Clearly, the markets did not believe the no-bailout clause in the Maastricht Treaty, agreed upon when the union was formed.
- As market discipline imposed by higher interest rates on the peripheral countries disappeared, they overspent and over borrowed, and created housing bubbles much like in the U.S., and also fiscal problems and eroding competitiveness.
- The center of the European Union – Brussels and the European Commission – also was unable to provide discipline. Decision-making in the union is flawed, reflecting the tension between sovereign states with democratic accountability and central control, where accountability has not been clear.
- Imbalances in government debt levels across the Eurozone are being addressed by tightening fiscal policies, raising taxes, and cutting spending, all of which put downward pressure on growth.
- At the same time, banks working to recapitalize are cutting back on lending. Tighter credit when economies are falling into recession is a recipe for disaster.
- Since 2008, unemployment has nearly tripled in Spain to roughly 23 percent, and has doubled in Greece to roughly 19 percent.
- Labor market reforms in the peripheral countries must be adopted to address imbalances in unit costs of labor throughout the Eurozone. In Greece, for example, the Constitution bars the firing of public employees. Reforms will be painful and bring further unemployment.
- Many steps are underway to address Europe's problems, although it is unclear whether they will be successful and how much contagion will affect the United States.