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Revitalising European growth

Nicholas Nanopoulos
CEO, Eurobank EFG
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Ladies and Gentlemen,

I am delighted and honored for the privilege to speak at the 2006 Forum organized by the OECD, on a subject of critical importance: the Revitalization of European Growth.

Today's European economy is plagued by a host of adverse factors: relatively slow growth; high unemployment; an ageing population; and in several countries a high level of indebtedness, coupled with an under-funded pension system. In addition, globalization and the resulting displacement of low value adding jobs out of Europe, have become an inescapable reality. Undoubtedly, faster economic growth would alleviate most of these problems. But how?

Economic growth, employment and wealth creation are driven to a large extent by improvements in productivity. Europe lags behind the US in GDP growth because of underperformance in productivity growth. And this situation prevails in spite of recent improvements in macroeconomic stability, and the efficiency gains derived from a better integrated European economy (introduction of the euro, EU enlargement). Few industrial sectors escape this gloomy state of affairs. One of them is mobile telephony, a relatively younger sector, immune from "legacy" structural problems.

In my view, Europe fails to do what the US does best: restructure and reduce employment in its "old" or mature industries and put all the emphasis of job creation in the "new" or dynamic ones. Without redeployment of human and financial resources from the least productive to the most productive sectors, it is hard to achieve stronger productivity gains and faster growth. In contrast to this, Europe adds relatively more jobs to the least productive segments of its economy.

From a broad range of policies, such as expanding R & D spending, promoting education, reducing taxes on gross wages and on income to spur economic initiative, I would like to single out three key measures, which would greatly enhance productivity and growth. The first measure is the restructuring of a very bureaucratic and unproductive public sector, which typically provides poor services, with little financial discipline and transparency, crowding out private sector initiatives. On the one hand, governments should aim at improving the productivity of the public sector. On the other hand, privatizations and the launching of public private sector partnership initiatives are useful means toward engaging the private sector more extensively in otherwise traditional public sector activities.

The second key measure is the introduction of greater labor market flexibility that includes: better labor mobility; more flexible working practices and hours; more emphasis on temporary employment; more decentralized and effective collective bargaining processes; and the ability to devise efficient mechanisms - preferably consensual, without consensus seeking becoming an alibi for inaction - for the withdrawal of excess workers.

The third key measure is the introduction of reforms in the product and service markets, in order to remove structural rigidities and improve competition. Enhanced competition can occur through simplification and harmonization of the regulatory framework across Europe, which would create a level playing field for all market participants, without protecting incumbents or national players at the expense of new entrants. After all, competition is the main driver of entrepreneurship, innovation and the adoption of new technologies, which in turn encourage further restructuring efforts.

Competition will also provide further impetus to consolidation, that will help extract economies of scale to the benefit of the consumer. Excessive consolidation can be a double-edged sword leading to oligopolies and weaker competition - hence the importance of strong competition authorities.

Turning now, as a banker, to the financial services industry, it is clear that our industry is instrumental in promoting economic growth. Improved competition, liberalization and deregulation in financial services, as well as healthy loan growth and efficient and transparent allocation of financial resources and effective management of risk, are well documented sources of productivity enhancement and growth world-wide.

Like in all other industries, productivity in banking could be enhanced through greater labor market flexibility, which would encourage further restructuring and consolidation. In addition, greater legislative and regulatory harmonization across Europe, as well as a reduction in public sector involvement in banking, would stimulate cross border competition. It would also bring about greater integration through in-market and cross - border consolidation.

Economies of scale in banking can be significant, and domestic consolidation has been shown to yield cost synergies in the order of 25% of the cost of the acquired entity. International consolidation also produces cost synergies, although these generally do not exceed 15% of the cost base of the acquisition target. Both domestic and international consolidation can also produce revenues synergies. The benefits derived either from cost savings or revenue synergies can be at least partially passed on to the consumer.

Domestic consolidation is often encouraged by the authorities in order to create so called "national champions", though such ambitions are sometimes tempered by the threat of massive employee lay offs, and the fear of creating domestic oligopolies to the detriment of the consumer.

International integration, for its part, is often hampered by cultural differences and country-specific banking customs, asymmetries in legal systems, and heterogeneous regulatory frameworks. It is often deterred by the expectation of modest cost and revenue synergies, or by protectionist local policies, often designed to sustain or develop "national champions".

Nowadays however, the observed generation of excess regulatory capital by the global banking system and the trend toward cultural, regulatory and supervisory integration are factors that will weigh heavily in favour of greater cross-border consolidation. Already, in 2005 cross-border M & A activity in European banking was about €50.0 billion, about triple the size of two years earlier. Such a trend toward greater European integration in banking may generate strong regional players with region-specific know-how and talent. I would argue that Greek banks have developed the expertise to be counted among the most active regional players in the area of south-east Europe.

Ladies and gentlemen,

Revitalizing European growth, while maintaining social cohesion, is not an easy task. It requires brave restructuring policies, independent of the political cycle that will help improve productivity and competitiveness, hopefully through a consensual process. The Lisbon agenda is an attempt in that direction, but it cannot be easily enforced. It is up to the individual countries to carry the task. And it is precisely the European countries that have managed to improve the efficiency of their public sector, such as Ireland, to develop a flexible labor market environment, such as Denmark, the Netherlands or Great Britain, and to engender competitive conditions in their product and service markets, such as Sweden, that have been the most able to generate strong growth and employment, to the benefit of their people.

I therefore suggest that we carefully study, adapt and follow such European success stories.