Klaus Liebscher: Reviving the European economy

Panel statement by Mr Klaus Liebscher, Governor of the Austrian National Bank, at the EPP-ED Group Study Days, Vienna, 23 March 2004.

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Ladies and Gentlemen,

the past three years are frequently cited as not having been too brilliant for the European economy. Triggered by adverse international developments, growth was sluggish or stagnated in the majority of Member States. Partly as a result, fiscal policies in a number of Member States slipped sharply into deficit, threatening the credibility of the Stability and Growth Pact. Progress on the implementation of the Lisbon Agenda was slower than hoped for, and the Lisbon Agenda is not accorded enough importance by observers. I want to argue today that things are not really that bad.

- Europe has very successfully managed to achieve economic convergence among its present 15 Member States.
- Europe has successfully introduced a single currency for 12 nations.
- Europe has designed an impressive agenda of structural reform at the Lisbon summit, and progress is being made.
- And Europe has shown remarkable persistence in the pursuit of its ambitious agenda of further development. Eastern enlargement, which future history books will quote as a landmark achievement on the path toward European integration, will become a reality in little more than a month's time, work on the draft Constitutional Treaty is very far advanced, and the EU is by no means short of important projects for the near future.

However, I will also argue that we must not be complacent. In today's globalized, fast-moving economy, more than ever standing still - or moving too slowly - is tantamount to falling behind.

To my mind, the euro is a success story in several respects.

That this outstanding project was realized bears witness to Europe's will to push forward with integration. That its introduction went so smoothly is testimony to the creativity, project management capacity and cooperative spirit of everyone involved. The euro has made all our lives easier. The euro also protects our economies to a large extent from foreign exchange turbulence. Today, our economies are - not completely, but to a considerable extent - shielded against the ups and downs of the U.S. dollar (just recall what that would have meant in the ERM I of the early 1990s!). Moreover, the Eurosystem's monetary policy has established sustainable price stability in the euro area. Inflation expectations have been stabilized at slightly below 2%. This signals the high credibility which the Eurosystem enjoys with professional analysts, financial markets and the general public. That success has only become possible against the background of the lasting consensus among European politicians that price stability is an important goal - both in its own right and as a precondition for sustainable growth.

I mentioned before that we must never become complacent. We take this appeal very seriously in the Eurosystem. The quarterly Bank Lending Survey, the new euro area-wide interest rate statistics or various measures of inflation expectations derived from surveys are just a few examples of continuous efforts the ECB and NCB staffs make to improve on the quality and diversity of the information sources employed to prepare the Governing Council's monetary policy decisions. The Governing Council also undertook a major review of its monetary policy strategy last spring, which resulted in several refinements of how we structure monetary policy considerations and how we communicate with the public.

Ladies and Gentlemen,

the ECB Governing Council has noted the progress in fiscal consolidation envisaged in the Member States' stability programs. Nonetheless, there continues to be cause for concern. In some countries, contrary to their commitments, adjustment efforts are insufficient to mitigate the risk of excessive deficits. Moreover, several countries do not plan to attain sound budgetary positions by the end of their respective program horizons, despite favorable growth prospects. This would risk a repetition of the policy errors of the last economic upswing, when insufficient consolidation efforts and tax cuts without adequate expenditure restraint laid the foundations for the recent fiscal difficulties.

All Member States would benefit from the strengthening of the sustainability of their public finances. Determined implementation of comprehensive structural fiscal reforms, on both the expenditure side and the revenue side, will bring additional medium-term rewards in the form of higher growth and more sustainable public finances.

Such consolidation and reform strategies are needed to secure a sound macroeconomic environment in the euro area, which in turn enhances confidence and promotes investment, growth and employment in the euro area.

As regards the institutional framework for fiscal policy, the Governing Council of the ECB shares the concerns of the European Commission regarding the conclusions of the ECOFIN Council in November last year. The Commission is the guardian of the Treaty, and the Eurosystem respects the Commission's decision to seek legal clarity on the implementation of the Stability and Growth Pact. We do not see a need to change the Treaty, and we consider the Stability and Growth Pact appropriate in its current form. It provides appropriate incentive structures to national policymakers within a multi-country monetary union. If applied appropriately, the framework ensures long-term sustainability and sufficient room for an automatic smoothing of business cycles. The Governing Council agrees with the Commission that the implementation of the Stability and Growth Pact could be further improved, in particular in terms of the analysis of structural imbalances and the strengthening of incentives for sound fiscal policies during good economic times. The clarity and enforceability of the fiscal framework should be enhanced.

Let me, as an aside, note that Austria successfully managed to implement its fiscal consolidation as planned over the past four years. The Austrian example shows that structural cuts in fiscal deficits need not entail below-average macroeconomic growth. As recent research by the European Commission shows, fiscal consolidation through cuts in expenditures is less likely to entail short-run growth-dampening effects than consolidation which relies on raising taxes. While recent tax cuts by a number of European governments, including that of Austria, are in principle appropriate given high public expenditure-to-GDP ratios, governments should use the coming economic upswing to bring their budgets into balance mainly through cuts in expenditures.

There is a general consensus that the euro area urgently requires further structural reforms in financial, product and labor markets. The Lisbon Strategy provides the appropriate blueprint for progress.

I think we can very much compare the current situation of the Lisbon Agenda with the state of EMU in the mid-1990s.

- Then as now a project of historical dimensions and of the highest priority for the EU's further economic development was at stake.
- Then as now there was a lot of scepticism about the project's viability and timetable.
- Then as now there appeared to be lackluster support from some European leaders.

The decisive move that brought EMU back on track in the mid-1990s was the meeting of the Euroepan Council in Madrid in December 1995. At that meeting, the date for the introduction of the European currency, January 1, 1999, the further steps necessary to reach this goal and the name "euro" were decided. This important guidance from European leadership established a "pioneering mood." It triggered the necessary work at the various technical levels dealing with the preparation of EMU. And, most importantly, it created confidence in European leadership and problem-solving capacity in the general public.

I therefore welcome that the forthcoming spring meeting of the European Council is set to give renewed impetus to the Lisbon agenda, speed up the pace of reforms and strengthen the effectiveness of the decision-making process. If done correctly and with the necessary commitment on behalf of the Member States, European leaders should be able to manage a revival of the Lisbon Agenda comparable to that achieved a decade ago on EMU.

Structural reforms will have enormous benefits for the citizens of the euro area. These reforms are crucial for sustained noninflationary growth and employment, and they are therefore also important for maintaining social cohesion in the long run. Confidence among European citizens in the future is vital for a stronger economic recovery and stable growth. The continued low level of consumer confidence is also related to uncertainties about the appropriate path for structural reforms in many euro area countries. Further progress in the implementation of necessary structural reforms is key to stronger confidence, and such reforms create the conditions for consumption and investment, for growth and job creation.

Let me emphasize a few points which in my opinion are crucial now to a successful revival of the Lisbon Agenda.

- **A first message is: Enough talk, now is the time for action!**
  The necessary reform areas have been sufficiently discussed and have been clearly identified. We do not need more reform papers now, we need implementation.

- **A second message is: Set clear priorities and use intelligent sequencing!**
  Otherwise both politicians and electorates will simply be overwhelmed and discouraged.

- **A third message is: Create clear responsibilities !**
  It is not sufficient for European leaders to issue declarations and conclusions on what "the Community" needs to do. We need a binding commitment by each Member State on the concrete reform steps that it will implement until 2010. The Maastricht convergence criteria would probably never have been fulfilled if there had only been reliance on a general intention that the Community requires price stability, sound public finances and the like. You need to break objectives down to the national level and create incentives to ensure implementation.

- **A fourth message is: Talk to people and get them actively involved!**
  I think a major obstacle to implementation of the Lisbon Agenda by the various governments is a lack of communication with the public. It is thus not surprising that it seems to be rather difficult for people to accept the reforms. Thus, each Member State government needs to convince its citizens of the enormous potential and opportunities released by structural reforms. After all, what we aim for is higher per capita income, replacing redundant activities with more welfare-generating ones, investment in skills and education, a knowledge-based society, more innovation and sufficient research and development. I would think that these objectives are of such a genuinely positive nature that it should be possible to convince people of the reform steps necessary to reach them. At the same time, one should not - and cannot - conceal that some of the reforms necessary on the way are painful or unpleasant, and affect various groups of societies in different ways. In such cases of strong conflicts of interest it is all the more important to enter into an active, constructive dialogue and to jointly find acceptable, fair solutions, since, in the long run, no government can afford to ignore public opinion. I think that some of the official documents prepared ahead of the forthcoming European Council already touch on the course I have just outlined, but to my feeling not sufficiently.

Let me conclude by quoting from Robert Schuman's legendary Declaration of May 9, 1950: "Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements."

I think that this statement is as true today as it was more than half a century ago. It will become even more relevant in an enlarged European Union of 25 Member States. While European leadership is becoming ever more important, the European Union can function well only if individual players perform their roles responsibly. This applies both to the division of labour between monetary, fiscal and structural policies and to the division of responsibilities between the EU and national governments. Sound fiscal policies and a rapid implementation of the Lisbon Agenda are both areas where individual Member States have a pivotal role to play. Now it is time to act.