

Jean-Claude Trichet: Interview with Il Sole 24 Ore

English translation of an interview with Mr Jean-Claude Trichet, President of the European Central Bank, Frankfurt, 16 March 2005.

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[Question] International competition has grown over the past few years. Europe's competitors are no longer just the United States and Japan. Many emerging economies, especially in Asia, are now highly competitive. There is a lively debate going on in many circles about Europe's economic decline.

[Answer] I believe that Europe needs to redouble its efforts to become more competitive. Failure to do so would be very costly. The ECB fully subscribes to the substance of the Lisbon agenda (the aim of which is to turn the European Union into the most competitive market in the world by 2010 – Il Sole-24 Ore editor's note) and to the European Commission's wish to press on in this direction, in line with the recent report on the same issue put together by former Netherlands Prime Minister Wim Kok. A good deal has been done, but we believe that a great deal more can still be done.

[Question] Everyone is stressing the need to introduce further structural reforms.

[Answer] The lag that has built up between Europe and the United States in terms of productivity growth since the mid-1990s is partially due to a lack of structural reform. It is not our intention to play down the difficulties in reforming the economy or in persuading society of the need for what are sometimes unpopular measures, but we also know that new reforms will help to boost economic growth, European prosperity and employment. In this sense, the ECB backs governments and all social partners in their efforts to introduce these measures.

[Question] The ECB prefers to look at the euro area as a whole, but not all member countries are in the same situation. Some of the larger countries are particularly behind in the race for greater productivity.

[Answer] You are right. The Governing Council of the ECB has to look at the region as a whole, in the same way as the Federal Reserve System in the United States looks at the US economy rather than at the economies of Massachusetts or California. That said, each individual European economy has its assets and its liabilities.

[Question] In that connection, what are your views on Italy?

[Answer] Italy has numerous qualities, including a very inventive and creative productive sector and dynamic small and medium-sized enterprises. But I will not pretend that it does not also have its weak points. Among these I could mention the increase in the unit labour cost, which has not helped the economy's competitiveness over the past few years.

[Question] For a long time Italy was able to stay competitive through the devaluation of its own currency. Now, with the euro, that strategy can no longer be pursued and its economic difficulties are more apparent.

[Answer] The birth of the euro has put an end to intra European currency crises, exchange markets and interest rates market tensions and bond market risk premia. It has enabled Italy, as well as the other eleven economies, to enjoy a historically low cost of money. This is a considerable advantage that should be fully recognised. Before the introduction of the single currency, we explained that in the Monetary Union indicators of competitiveness, as for example unit labour costs, would be very important to monitor in order to ensure the success of individual national economies. It is very important to introduce economic reforms today precisely to reduce the unit labour cost through appropriate labour productivity progress.

[Question] But in many countries there is growing concern over international competition at a time when the implementation of economic reforms is also triggering uncertainty on the welfare front. Some days ago the European textile industry called on the European Commission to levy duties on Chinese goods. What do you think of that option? Can the introduction of duties make up for the lack of flexibility in the exchange rate?

[Answer] I will of course respect the division of responsibilities amongst the European institutions: it is up to the Commission and the Council to make their judgment. As regards the ECB we see

international trade as an important element which has contributed to global growth and prosperity. Since World War II open trade has functioned as an effective win win game. And it is true that the very rapid development of the big emerging economies, in particular in Asia, is a new important challenge for all the industrialised economies and calls for equally rapid adaptation of Europe to this new global deal.

[Question] In recent weeks the ECB has been stressing the fact that in Europe not much use is being made of the new technologies that could help to boost the economy's productivity. Can you explain the reasoning behind your concerns?

[Answer] There are a number of signs that are suggesting that the IT revolution has not yet materialized in the European labour productivity progress. In the United States it occurred between mid 1990's with the disappearance of the so-called "Robert Solow paradox" ("Computers are found everywhere but in the productivity data" – Il Sole-24 Ore editor's note). So we are convinced that fresh efforts are needed in Europe to take full advantage of the IT revolution and to foster research and technological innovation. Scientific and technological progresses today are remarkable and are calling for renewing the production process not only in the manufacturing sector but also in the services industry. I trained as an engineer, and from that point of view too I am amazed when I see how fast scientific progress has been in recent years.

[Question] Yet Europe has made considerable efforts in this field over the past few years. Some countries are out in the forefront in terms of Internet and mobile phone use. Why do you believe that the euro area still lags behind?

[Answer] We suspect that the IT revolution is taking its time to materialize because Europe has to reckon with goods, services and labour markets that are still not very flexible, or in any case less flexible than in other economies. We are convinced that less flexible economies and companies benefit less and later from scientific progress. Moreover, I would add that Europe is unfortunately not yet at the heart of technological and scientific innovation. So, in that sense, we have to renew our efforts in research, innovation and the economy of knowledge, while at the same time making our economic fabric more flexible.

[Question] But some countries in Europe are managing better than others.

[Answer] That is true. There are countries where the virtuous cycle of economic reform, IT revolution and increased productivity, growth and employment have taken root. I would mention the Scandinavian countries and Ireland in particular. From that point of view, there is no need to look outside the Union: There is no lack of reference points in Europe and in the euro area that can be taken as effective benchmarks for those countries that are having greater difficulty in pursuing reform.

[Question] Many people in Europe are convinced that in the current context – not only the economic context but also the social context – a more flexible Stability and Growth Pact would be useful. That issue is at the heart of a debate among the EU's Member States right now.

[Answer] This is a very important issue. You know the position of the ECB's Governing Council which has been expressed already a year ago. The proposal of improving the efficiency of the preventive arm of the Pact is a good one and we supported it from the very beginning. But we think that as far as the corrective arm of the Pact is concerned it is important to fully preserve the nominal benchmark of 3% deficit and the integrity of the excessive deficit procedure. The Commission proposes. The Council will decide. It was, and it is, our duty to say what we think taking into account the crucial importance of the Stability and Growth Pact for the cohesion of Economic and Monetary Union. In any case, whatever the decision is we will be faithful to our mandate and maintain price stability.

[Question] In this context of low growth and low output, the fact that the population is ageing plays an important role too. Is that a factor that the ECB takes into consideration?

[Answer] That is a very important feature. In many euro area countries we are seeing a gradual increase in the less dynamic and less active part of the population, which in general leads to a fall in consumption and investment with the resultant negative effect on the economy. That is another reason why reforms of the health and pension systems and the labour market are crucial. In some countries, specific policies have been adopted to correct this demographic trend.

[Question] Of course, low growth in productivity also has an impact on inflation.

[Answer] Of course. Low growth in productivity means higher unit labour costs. Cost-generated inflation tends to rise, and that certainly does not make the ECB's task any easier, given that our job is to maintain price stability within the Monetary Union.

[Question] On the subject of inflation, the ECB has estimated the euro area's non-inflationary potential growth rate to be between 2.0% and 2.5%. Can you confirm that estimate?

[Answer] The ECB relies in this field also on assessments of market economists' consensus and on analyses conducted by other major international organizations. We have noticed that this estimate has been revised downwards recently. If I were to mention a figure today, I would say that a number of estimates are getting closer to 2% than to 2.5%.

[Question] Drawing to a conclusion this structural analysis of the European economy's problems, allow me to ask you one more question on the economic climate. What is the ECB's forecast for growth in Europe in 2005? Is the monetary institute optimistic?

[Answer] We are neither optimistic nor pessimistic. Rather we are realistic and humble in front of facts and figures. The ECB's economists have revised downwards their growth projections for 2005 (from 1.4%-2.4% to 1.2%-2.0% – Il Sole-24 Ore editor's note) as a consequence of the slowdown in the second half of 2004. There have recently been signs of greater dynamism in investments and in internal demand. We will have a clearer picture of the situation with the figures for the first quarter of 2005. I would say for the time being that we can stand by our diagnosis of continued moderate growth in the euro area.