Mario Draghi: Competitiveness of the euro area and within the euro area

Speech by Mr Mario Draghi, President of the European Central Bank, at the colloquium "Les défis de la compétitivité", organised by Le Monde and l'Association Française des Entreprises Privées (AFEP), Paris, 13 March 2012.

*   *   *

Ladies and gentlemen,

I am delighted to have the opportunity to participate in this debate.

Competitiveness is a key issue of economic policy in each and every country of the euro area. It is a key issue for the euro area as a whole. And it is of fundamental importance to the lives and long-term prosperity of all of our citizens.

We at the European Central Bank (ECB) have a steadfast commitment to price stability. This in turn provides support for economic growth and job creation across Europe. But for any individual member of the euro area to prosper in a globalised world, our contribution needs to be complemented by the work of national policy-makers.

Future prosperity requires us all to establish and maintain a competitive position, both inside and outside the euro area. These external and internal dimensions of competitiveness will be the main focus of my remarks. But first let me say a few words about how we see the current economic situation.

The state of the euro area economy

Overall, we see continued signs of stabilisation in the euro area economy, albeit still at a low level. The situation in financial markets has clearly improved in response to the ECB's measures. The improvement is also due to the progress made by euro area governments towards accepting more binding common fiscal rules and by the progress on fiscal consolidation and economic reform in many countries.

Countries should use this phase of financial stabilisation to make further progress on their programmes of economic reform – to strengthen their potential growth, to boost employment and to enhance competitiveness.

Banks too should use this currently more benign environment to strengthen their resilience further, including by retaining earnings, cutting dividends and bonuses. The soundness of banks' balance sheets will be a key factor in facilitating an appropriate provision of credit to the economy, which is their main task. The financial system should serve the real economy, not the other way around.

As far as monetary policy is concerned, growth will be supported by the very low short-term interest rates and by all the measures adopted by the ECB to foster the proper functioning of the euro area's financial sector.

Taking the context of deeply malfunctioning credit markets, our recent decision on medium-term liquidity has been central in banks returning to play their vital role in the real economy. Banks account for over two thirds of external financing of firms in the euro area. Banks are especially important for small and medium-sized enterprises, which account for nearly three quarters of employment in the private sector.

As many as 800 banks participated in our last operation. They cover virtually the entire euro area. Many of the banks are small, regional institutions. I cannot even mention their location, the towns, the villages where these banks are, because often they would be the only bank in town so they could be identified. This tells us one thing – that the money is now closer to households and the small and medium-sized enterprises than it was before.

We are continuously alert to the risk of inflation, but this risk is not materialising at the present time. Moreover, inflation expectations remain firmly anchored in line with price stability. All the necessary tools to address potential upside risks to medium-term price stability are fully available.

Over the past 13 years, the ECB has achieved one of the best records of price stability in European history. We are committed to maintaining that record.

The recent signs of stabilisation allow us all to face the medium-term challenges for the euro area with a degree of confidence. All policy-makers should take advantage of this position to continue their reforms with confidence.

Competitiveness: the external and internal dimensions

Let me turn now to the theme of this conference and explain the term competitiveness.

Competitiveness, broadly defined, is firmly grounded in a notion of relative productivity: a competitive economy is one that provides the institutional environment necessary to foster the development of highly productive firms.

Such firms have the capacity to sell their goods and services abroad easily and profitably, contributing to longer-term economic growth and employment and, ultimately, to the welfare of citizens.

But competitiveness is not only international price competitiveness. Competitiveness is also related more broadly to a country's external performance. Analysis of this broader concept of competitiveness includes indicators of export growth, market shares and current account balances.

Prices, costs and wages are important factors in determining the ability of firms to compete in international markets. But for firms – and thus countries – to adjust successfully to the big changes implied by globalisation, other factors have become increasingly important.

These include the range and quality of the products a country exports. In this regard, countries in the euro area can take advantage of their high technological advancement and well-educated labour forces. They should be producing higher quality and more sophisticated goods, and redirecting their exports towards strongly growing markets.

Against this background, the domestic environment in which firms operate is central to fostering competitiveness. Countries whose firms compete successfully in international markets are in general those with better technology, a higher degree of openness and greater domestic market competition.

A growing body of cross-country evidence confirms that policies to promote competition in Europe's markets for goods and services clearly raise the potential for growth and job creation at little or no cost to the public purse. Continued efforts to promote stronger competition and further market integration within Europe are important tools for enhancing the global competitiveness of European firms.

In this vein, supportive national economic environments – including well-conceived physical and social infrastructures, sound public finances and, I should emphasise, stable financial systems – will all contribute to the competitiveness of the euro area.

Let me go a little deeper into the challenges of competitiveness for Europe's economy. For the euro area, we have to distinguish between two distinct concepts: the external competitiveness of the euro area as a whole in the global economy; and the internal competitiveness of the various countries within the euro area.

External competitiveness

Let me start with external competitiveness.

The euro area has actively contributed to the rise in international trade that is one of the defining features of globalisation. In the last two decades, the openness of the euro area has increased markedly.

In the mid-1990s, exports of goods and services from the euro area as a whole to the rest of the world were equivalent to 15% or less than one sixth of GDP; now they amount to 23% or nearly a quarter of GDP. Even though we are roughly comparable in size to the United States, the euro area is about ten percentage points more open, and we are much more open than Japan despite our larger size.

This also means that we have ample evidence that any fears of a “Fortress Europe” were completely unfounded. On the contrary, we are the most open of the largest economies.

External performance in terms of the current account shows that the euro area as a whole has performed well, and that external imbalances have been kept in check. The euro area’s current account has traditionally been close to balance, compared with sustained deficits in the US and sustained surpluses in Japan.

Of course, remaining competitive is a continuous challenge. Over the past two decades, as low-cost competitors have emerged elsewhere in the world, the euro area – like other advanced economies – has recorded some decline in export market shares. These losses partly reflect the mechanical effect of the new entrants. Nevertheless, the euro area does need to adjust the range of goods, services, sectors and industries in which it specialises.

Euro area countries have changed their specialisation over the last two decades, but not all did so to the same extent. As a consequence, the specialisation of the euro area as a whole has not changed much. We could have expected that the euro area would have shifted more towards higher quality products and products that are more skill-intensive and capital-intensive.

The fact that there has not been more progress overall might reflect structural rigidities that constrain firms’ ability to adjust rapidly and to make substantial changes in their specialisation – particularly towards high-technology products.

In particular, rigidities in the product and labour markets make it difficult for firms to adjust costs and prices to changing conditions. The ability of countries to adopt the appropriate specialisation may also be limited by structural issues related to the quality of education and the incentives for innovation.

Internal competitiveness

The general picture for the external competitiveness of the euro area is positive.

But this general picture does not necessarily hold for each member of the euro area.

Overall, looking at competitiveness within the euro area, there have been substantial differences across countries.

Indeed, the strains in some sovereign debt markets have been compounded by the severe competitiveness differentials that have emerged within the euro area.

A convenient way to identify competitiveness differentials is simply to look at the current account balances of each country.

Current account imbalances could be justified for any country, including those participating in a monetary union, and they do not necessarily reflect a loss of competitiveness. But increasingly, larger current account deficits have resulted from significant losses of national competitiveness, signalling domestic macroeconomic imbalances and deeper structural problems. These losses of competitiveness limit the country's growth potential and hinder its participation in the global trade integration.

Against this background, rather than financing productive investment in the tradable sector and fostering export performance, capital inflows in some countries with excessive current account deficits have fuelled asset price rises and private indebtedness. Hence, current account imbalances within the euro area should be a source of concern for policy-makers when they relate to losses of competitiveness.

A useful way to measure excessive imbalances is to look at unit labour costs, as these reflect developments in both productivity and labour costs. If we compare countries with an external surplus and countries with an external deficit, we see that, since the introduction of the euro, unit labour costs have increased by 28% in deficit countries, 2.5 times as much as in surplus countries.

For sure, some of this differential might reflect sustainable increases in income per capita or other "catch-up" effects. But to a much larger extent, this differential relates to structural problems and reflects growing misalignments between developments in wages and productivity.

These misalignments have also become visible in terms of deviations from price stability. Indeed, we can observe that most countries with strong current account deficits prior to the crisis had also experienced substantial increases in prices.

Ensuring price stability is key for competitiveness.

It provides the nominal anchor for future price developments. It is key for the euro area as a whole as much as it is key for all countries.

Significant and persistent deviations from price stability translate into losses of competitiveness and should be corrected.

Restoring competitiveness is vital for a number of countries within the euro area. Policies to ensure sufficient responsiveness in wages and prices, as well as to boost productivity, are crucial ingredients in the rebalancing.

The policy challenge

Let me conclude. The euro area's performance in the global economy is good, but continuous adjustment is needed to keep up in a highly dynamic international environment.

Within the euro area, a number of countries need to repair and strengthen their competitiveness for the sake of their own continued prosperity and the overall stability of our economic and monetary union. This process requires going to the root of the loss of competitiveness, tackling its sources and enhancing the opportunities for growth.

The time frame of this correction will differ according to the degree of the imbalances and countries' overall economic conditions. But in times of severe financial constraints, there is no other choice than to address the structural losses in competitiveness in an urgent and decisive manner.

What monetary policy can do for competitiveness is to ensure price stability in the euro area, reducing risk premia and making sure that all the transmission channels of the monetary impulse do work.

I would add that the markets clearly understand that. Thus, continued price stability, unencumbered credit markets, fiscal consolidation and structural reforms that decisively address the issue of insufficient growth stemming from loss of competitiveness would bring about an increase in confidence. And, as I am sure we all understand, increased confidence will further contribute to Europe's recovery and to our longer-term potential for growth, jobs and continued prosperity.

Thank you.