Jean-Claude Trichet: Willem F Duisenberg Fellowship of the Netherlands Institute for Advanced Study

Introductory remarks by Mr Jean-Claude Trichet, President of the European Central Bank, at the inauguration of the Willem F Duisenberg Fellowship of the Netherlands Institute for Advanced Study, Amsterdam, 28 February 2008.

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Ladies and gentlemen,

It is a great pleasure for me to be here today in Amsterdam to inaugurate the Willem F. Duisenberg Fellowship of the Netherlands Institute for Advanced Study.

I am particularly delighted to be here for two reasons. First, this new Fellowship was set up in honour of Wim Duisenberg, the first President of the European Central Bank (ECB), who successfully led us through the uncharted territory of introducing the euro as the new currency for the, by now, around 320 million fellow European citizens. Second, the Willem F. Duisenberg Fellowship establishes another European programme that will foster top-quality research in the field of applied monetary and macroeconomics. It will thereby contribute to the continuous upgrading of our knowledge in these areas of research, which is fundamental for the sound conduct of monetary policy and of economic policies in the euro area.

Let me also say now that we are in the purdah period as far as the Governing Council of the ECB is concerned. Nothing in what I will say is intended to and should be interpreted in any respect in terms of future monetary policy.

The ECB has, from the very beginning of its existence, attached great importance to establishing close ties with academic research, in order to ensure the constant exposure of our analyses and views to external ideas and expertise. We foster these close ties in various ways. We frequently co-organise conferences, workshops and seminars on topics relevant for policy-making in the euro area. To give you an idea, last year alone, we were involved in the organisation of 17 such events. Furthermore, we also frequently invite academics to come to the ECB to present their work, for example, in the context of a weekly, invited speaker seminar, called the Joint Lunchtime seminar, which we organise together with the Center for Financial Studies and the Deutsche Bundesbank. In addition, we make sure that the analytical output of our staff members is regularly presented and discussed at international research seminars and conferences. Finally, our close links with academia are also promoted through external consultancies and visiting research fellowships.

In order to ensure that there is fruitful interaction with academic researchers, we need to maintain strong in-house analytical capabilities at the ECB. This allows us to continuously follow the latest developments in academic research and to assess their relevance for monetary policy. It also enables us to better connect the worlds of academia and policy-making, as well as to identify and to contribute to closing gaps in research areas where we feel more in-depth knowledge is required to support policy-making. This has been successfully carried out, for example, in the context of a number of Eurosystem research networks that have been led and coordinated by the ECB, the past Monetary Transmission and Inflation Persistence Networks and the currently ongoing Wage Dynamics Network.

While keeping up with academic research, which is very important for central banks, we must at the same time refrain from jumping immediately on the bandwagon of every new paradigm that is proposed by some academic researchers. Prematurely accepting new, untested theories entails the risk of serious policy errors if such work turns out to be flawed. This is what the experiences of the past have taught us.

In the 1960s and 1970s, many economists subscribed to the view, which was also supported by a number of leading academic researchers at the time, that a permanent trade-off between inflation and unemployment existed, and that inflation was, to a large extent, driven by non-monetary factors outside the realm of monetary policy. This view also influenced a significant number of central banks' policy conduct at that time, leading to an overly-expansionary monetary policy stance, eventually resulting in what is today known as the Great Inflation. These developments brought academic researchers and monetary policy-makers to recall in particular one long-standing macroeconomic principle that had fallen into oblivion: that inflation is ultimately a monetary phenomenon, meaning that inflation is, in the long run, solely determined by monetary policy.

Today, there is far-reaching consensus between academics and policy-makers, distilled through decades of academic reflection and policy experience, that price stability is a necessary condition for sustained economic growth and sustained job creation, and that the responsibility for price stability is best placed in the hands of an independent central bank. This consensus is enshrined in the ECB's and many other central banks' institutional architecture, which is characterised by two constituent features: a clear mandate to safeguard price stability, and institutional independence in order to ensure that this mandate is effectively pursued.

While monetary policy can make an important contribution to economic welfare by maintaining price stability, and thereby eliminating distortions arising from high and volatile inflation, the development of growth and employment are ultimately determined by the structural features of an economy. Well-designed structural policies promoting flexibility in product and labour markets, enhancing education and training and fostering research and development are, therefore, crucial for the long-run performance and smooth functioning of an economy. This holds particularly true in a monetary union like the euro area, where national monetary and exchange rate policies are no longer available as adjustment mechanisms.

Recognising the need for sound structural policies, the Member States have established a comprehensive reform agenda in the context of the Lisbon Strategy aiming at enhancing the growth and employment potential of the euro area countries. Yet, while there have been some remarkable improvements, reflected, in particular, in the creation of 15 million new jobs in the euro area since the start of Economic and Monetary Union (EMU) compared to only around three million new jobs in the nine preceding years, in many countries, structural reform efforts have not sufficiently enhanced the flexibility and efficiency of product and labour markets. This is evidenced by the still unacceptably high unemployment rate in some regions or segments of the labour market, and the very low level of labour productivity growth in the euro area.[1]

Implementing and carrying out structural reforms is undoubtedly a challenging and arduous task. However, it is particularly important to resolutely pursue such reforms in the current environment, where the euro area economy is facing a number of important challenges, including rapid technological change, accelerating globalisation forces and ageing populations.

The experience of those European countries, which have undertaken courageous and successful reforms in the past, shows that they pay off.[2] The Netherlands is one such country, and is now characterised by a flexible labour market with the lowest unemployment rate in the euro area at 3.2% in 2007. In addition, with a total participation rate of 78.5% in 2007, the highest in the EU, and a female participation of 72.2%, two of the Lisbon objectives have already been met.

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1 The annual growth rate of real GDP per hour worked in the euro area averaged only 1.3% over the period 1999-2006.

2 See A. Annett (2006) "Lessons from successful labour market reformers in Europe", IMF euro area policies: selected issues, August 2006.

I would like to turn now to some of the reform policies pursued in the Netherlands that led to the remarkable performance of the Dutch labour market over the last quarter of a century. Speaking of structural reforms, and the successful reforms carried out by the Netherlands, it seems fitting that Professor Boeri, who is known as a forceful exponent of economic liberalisation and structural reform in Europe, and in particular in his own country, will be conducting his fellowship at the Netherlands Institute for Advanced Study located in Wassenaar, where, 25 years ago, the decisive Wassenaar Agreement was signed, steering the course towards change and initiating the remarkable and substantial recovery of the Dutch economy.

The main outcome of the Wassenaar Agreement was the establishment of wage moderation, which, in turn, helped firms to restore profitability and stimulate both investment and employment.[3] Prior to this agreement, the Netherlands had been gripped in a wage-price spiral. However, through this agreement, which considerably diminished wage indexation, a platform for the remarkable turnaround of labour-market performance was created.

In addition, a continuum of supportive policy frameworks aimed at reforming labour market institutions was adopted, thereby ensuring the underpinning of wage moderation.[4] The expansion of the part-time and temporary agency work sector in the Netherlands, combined with the implementation of effective policies, has resulted in both greater flexibility in the labour market, and job certainty for part-time and temporary agency workers. Moreover, it has assisted in alleviating the “insider-outsider” characterisation of the European labour market. Furthermore, the steady reduction in tax wedges and reforms of the benefit system, in particular, the shortening of the maximum duration of unemployment benefits and the reforms governing the disability scheme which were implemented over several years, have also helped increase the labour market’s performance.

What the Netherlands and all successful reformers have in common is that they have, in parallel, successfully reduced product market regulation. This has led to more effective employment growth following an increase in labour supply, as wage moderation has fed through to jobs as opposed to rents.[5] On this score, the proposed policies to further enhance the innovative environment of the Netherlands should be commended. In summary, a successful reform programme is more than just the sum of the individual reform policies due to the synergies that are created. Additionally, and as Professor Boeri has recently pointed out,[6] there can be no steps backward in undertaking and implementing reforms, particularly with the need for greater flexibility in this era of rapidly changing economic environments.

Being here in Amsterdam today, on this given occasion, I should also like to take the opportunity to recall the successful transition to Economic and Monetary Union (EMU). It was here in the Netherlands where the milestones, on the way to this truly historical achievement, were set. The Maastricht Treaty, signed in February 1992, and the Stability and Growth Pact, sealed here in Amsterdam in June 1997, laid down the institutional framework for EMU, which provided the basis for the successful transition to the euro and the ECB’s price stability-oriented monetary policy. And it was the Dutchman Wim Duisenberg, first President of the European Central Bank, who we are honouring here today with the inauguration of this new Fellowship, who led us into the most decisive phase of the monetary union. Indeed, for most of the 1990s, global investors and market participants had been lukewarm and sceptical vis-à-vis the prospects for EMU. But, in 1998, the markets radically changed the

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3 See J. Eriksson and E. Udden-Jondal (1997) “Lessons of the Dutch model”, Riksbank, Quarterly Review 3/4.

4 See A. Annett (2006) “Lessons from successful labour market reformers in Europe”, IMF euro area policies: selected issues, August 2006.

5 See A. Annett (2006) “Lessons from successful labour market reformers in Europe”, IMF euro area policies: selected issues, August 2006.

6 T. Boeri, “Europe is caught mid-river in labour reforms”, Financial Times, 16 January 2008.

way they viewed EMU, recognising that the new currency would display the best — not the average — characteristics of the currencies that it was designed to replace. All along the yield curve, the future euro-area market interest rates became progressively aligned with the lowest market rates denominated in the most credible currencies, reflecting the stabilisation of inflation expectations in the euro area at the levels prevailing in those countries with the best monetary tradition available in Europe. All of us at the ECB, and at the national central banks of the Eurosystem – in the Netherlands the Dutch Central Bank with Nout Wellink at its helm – we will continue to preserve this legacy and to do our best so that, as Wim said, “in the end history judges our new, shared currency to be a success.”[7]

7 W. Duisenberg, Address delivered on the occasion of a special ECOFIN dinner to pay tribute to his leadership of the European Central Bank, Venice, 29 October 2003.