Jörg Asmussen: Is Europe on the right track?

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the Deutsche Bank Women in European Business conference "Competition versus Coalition – the quest for growth?", Frankfurt am Main, 20 March 2013.

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Dear Ms. Siebert,

Dear Mr. Leithner,

Ladies and gentlemen,

Thank you very much for inviting me to speak at the Women in European Business Conference organised by Deutsche Bank.

The topic of this year's conference – the quest for growth – could scarcely be more relevant for Europe today.

As this audience knows better than most, the low growth environment is posing serious challenges for businesses. Uncertainty about the future is a drag on confidence and a barrier to new investment. It causes banks to cut back on lending, especially to small- and medium-sized firms, which are critical to help growth rebound.

And above all, low growth is deeply affecting the lives of ordinary people in Europe. As a result, many are frustrated, and some are even desperate. They doubt whether the European strategy to deal with the crisis is the right one. They are asking: "Will we ever come out of it, with ever more cuts and austerity?"

And it is right and legitimate that they are asking this. "Power of the masses" is a key theme of this conference. We are democratic societies in Europe and these important choices about the future of our countries and our monetary union require a proper public debate.

But this debate also needs to be based on substance.

Rage alone does not solve our problems.

Just being angry at politicians or officials, even if justified, does not help citizens understand the crisis. People need to be presented with the real choices facing them – even if that means taking hard decisions or making sacrifices.

Offering allegedly easy solutions, or presenting false alternatives, abandons the debate to populists and gambles with the long-term prosperity of our societies.

So today I would like to present my view on the choices that are facing Europe – and in doing so, to expose some of the myths and misconceptions about the European approach to managing the crisis. Concretely, I want to answer two questions:

- First, are there alternatives to the current strategy, and if so, what are their real consequences?
- Second, are we condemned to a "lost decade", or can we find new sources of growth to lift us out of the crisis?

1. The reality of the alternatives

Policy-makers sometimes speak about certain courses of action as being without alternatives – "alternativlos" as we say in German.

Of course, this is not true. There always *are* alternatives. The question is whether they are superior, especially when assessing their likely impact and longer-term consequences.

So let me begin by looking at those alternatives.

As you know, one pillar of the crisis response in Europe has been to consolidate government budgets. Progress has so far been good: the European Commission estimates that, by the end of this year, the euro area as a whole will have a budget deficit below 3% of GDP.

But this progress has also had costs in the short term: growth has turned out to be lower than forecast and unemployment has risen steeply. Almost 19 million people in the euro area are currently without jobs – this includes almost one in every four young people.

In the face of this hardship, the strategy of reducing deficits has come under increasing criticism from commentators and politicians.

Some now urge an “exit from the austerity cage”.

Others claim that, by continuing to cut deficits when growth is so low, policy-makers are ignoring the evidence, even being ideological. To exit the crisis, they say, Europe must engage in an urgent change of course: more time, less austerity; more public money, less reform.

Let me be clear: I am also very concerned by the high level of unemployment. I would also like to see stronger growth.

But before proposing to change course, we need to think through the consequences. This is what responsible policymaking means.

And put simply, the consequence of stopping cutting deficits is to increase public debts. Is this a feasible or sustainable solution to our problems?

The real consequences of changing course

In my view, the answer is “no”.

First, regardless of its merits, such a strategy would only work *if* private investors were willing to finance higher borrowing at reasonable rates. And that is certainly a big “if”, especially for countries whose debts are already very high and rising.

Second, it is an illusion to think that more debt is the answer to this debt crisis. Recent research has shown that high public debt levels in the euro area hamper growth, with a serious negative effect starting when debt exceeds 90% of GDP. Average euro area public debt is *already* above that level – almost 95% of GDP – so adding more debt will only put us further into the danger zone.

Third, a strategy of increasing debt simply pushes problems in to the future. Any benefits for the current generation come *at the expense of future generations*. Higher borrowing today means higher interest payments tomorrow – which have to be paid off with the taxes of tomorrow’s citizens.

Moreover, the more today’s generation consumes, the more future generations will have to save to get the debt level back down again. And they *will* have to do this: as part of the new EU debt rule, all euro area countries are legally bound to start reducing their public debts below 60% of GDP.

To give a sense of what this means, take the example of Italy. Public debt is almost 130% of GDP, so it will have to be more than halved by the next generation to abide by the debt limit.

Around 80 billion euros a year goes on debt service – this is more than 10% of the annual budget, which is not being spent on education or infrastructure.

On top of this, future generations will face a number of hidden costs that have not yet been factored into the debt figures. These include the effects of an ageing society and the unknown consequences of a changing climate.

To take the example of Germany, the European Commission projects in its 2012 Ageing Report that the working age population will fall by more than 30% by 2060. At the same time, its age-related spending will continue to increase. This means that, year after year, there will be an ever smaller number of workers supporting an ever larger social security system.

Our obligation to future generations

In other words, future generations are *already* carrying major burden. Is it fair to them, by increasing debt today, to make it heavier still?

The economist John Maynard Keynes famously dismissed long-term considerations with the argument that "in the long-run we're all dead". This is true – *we* are, but our children and grandchildren are not. By ensuring fiscal soundness today, we represent *their* voice in the current debate.

To sum up, I question the benefits of changing course, not because I am satisfied with the current situation, but because *the alternatives available are worse*. They mean placing short-term expediency over long-term sustainability – which, for me, is the opposite of responsible policy-making.

Citizens have to take decisions of great importance about their future – most directly so when they are asked to at the ballot box. By casting their votes, they make choices that will not only determine their lives, but also those of the generations to come. They deserve to have the full picture of the alternatives they are facing before they do.

2. The potential of the European strategy

But citizens still rightly ask: where will growth come from?

This leads me to the second theme of my address today. Is the euro area condemned to a "lost decade" of low growth and high unemployment? Or are there new sources of growth we can exploit to get out of this crisis?

Here, the answer depends on governments themselves. The truth is that they are not out of options when it comes to growth. There *are* new sources of growth that can be tapped, even while budgets are being cut.

But to do so, they have to implement the other pillar of the European strategy. They have to enact deep-rooted economic reforms that increase the potential of their economies to grow.

Reforms to open markets, increase competition, and remove bureaucracy. Reforms to advance innovation, encourage entrepreneurship, and help public administration actually serve the public.

These reforms are not easy to implement. They require tough choices, perseverance to confront vested interests, and patience for the effects to become visible.

Reforms as the path to growth…

But their potential is huge.

To give a sense of what can be achieved, recent research from the IMF[1] finds that euro area countries could boost their GDP by more than 3% over five years by opening markets to competition and reforming tax systems.

And they could also do a lot to support growth by removing the remaining barriers to a Single Market in Europe – in particular by completing the Single Market in services.

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1 Barkbu, B., Rahman, J., Valdés, R., "Fostering Growth in Europe Now", IMF Staff Discussion Note, June 2012

The European Commission estimates that implementing the Services Directive – which covers activities that make up around 40% of EU GDP – could reap additional gains of 330 billion euro, or more than 2.5% of EU GDP, over five to ten years.

And this only requires implementing legislation that has *already* been agreed.

…and fairness

Higher growth is not the only benefit from reforms: they also contribute to a *social fairness*. As the OECD Going for Growth 2012 report put it, this is the "Double Dividend" of structural reforms.

Commentators who criticise the social consequences of the European strategy often forget this element and focus only on the effect of budget cuts – which can sometimes fall hardest on vulnerable groups in society. But well-designed reforms can have the opposite effect: they can in fact *create* opportunities for people on the margins of society.

Let me allude to this:

In Spain, there is a rigid two-tier labour market which protects insiders. This means that young people, on flexible contracts, bear the burden of an economic downturn. As a result, almost 6 out of 10 are currently unemployed.

In another country, the administration of tax collection is weak which leads to enormous amounts of tax arrears. As a result, ordinary people who are taxed on their salaries have to pay more to make up the difference.

These are both cases where lack of reforms leads to unfair outcomes – and so where structural reforms could help towards a fairer society. Ultimately, with structural reforms, the winners outnumber the potential losers. It is time this message gets more attention.

The never-ending race

However, we should not fall into the trap of thinking that it is only struggling countries that need to take hard decisions. We are all competing today, both within Europe and with the rest of the world. There can be no sitting back, for any country.

Germany was a decade ago called "the Sick Man of Europe"; people were wondering publicly if "Germany can be saved". Since then, the country has become a showcase of how well-designed reforms can turn the situation around.

But this example also serves as warning – others can just as quickly catch up. If struggling countries continue to pursue ambitious reforms, and Germany rests on its laurels, it could once again be this country left in the slow lane.

So it also needs to tap new sources of growth, like professional services, that remain unreformed.

3. Conclusion

Let me now conclude.

The challenge avoiding false alternatives, and taking the hard decisions, is not a new one. Niccolo Machiavelli observed in the 16th century that,

"*There is nothing more difficult to carry out than to institute a new order of things. Because the reformer has for enemies all those who have profited under the old conditions and lukewarm defenders in those who may do well under the new.*"[2]

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[2] Niccolò Machiavelli, The Prince, 1532

We at the ECB are no different: we also have structural problems to address. And since I am speaking at the “Women in European Business” conference, let me focus on one in particular: the underrepresentation of female staff in our management positions and governing bodies.

For a very long time, I was personally not in favour of any kind of affirmative action, because I was convinced that qualified women would eventually make their way to the top. But I have come to realise that this is not the case – neither in the working environments I am familiar with, nor on a wider scale.

I was struck when I heard that it will take more than 70 years to achieve gender-balance in the UK’s largest 100 companies if the current rate of change is maintained.[3]

The ECB’s Executive Board recently discussed enhancing gender diversity in our management and decided that, from now on, we will not only talk about diversity – we will act. All studies show that the commitment from the top is key to bringing about change. The commitment is there – we want new measures and the board has asked its Human Resources department to provide these to us. Other international financial institutions like the IMF and the EIB as well as the European Commission are more advanced and have introduced gender targets, which define specific quantitative – albeit non-binding – goals for employing women at various levels. We think that we can learn from the experience of these institutions and that their targets may serve as a benchmark for us.

This marks a significant change, especially in the generally rather conservative world of central banking. All change implies a challenge, especially for those at the top of the organisation. But leadership *must* be challenged to keep it relevant – which is another theme of this conference. The key issue is how, when challenged, it answers.

The current concerns about where Europe is heading are a challenge to our leadership. They have to be properly answered. Not by resorting to populism or false alternatives – but by reaffirming, clearly and honestly, why the path we are taking is the right one.

Thank you for your attention.

[3] Equality and Human rights Commission, 2008