Mr Duisenberg looks at the euro and a dynamic Europe

Speech given by Dr Willem F Duisenberg, President of the European Central Bank, on the occasion of a conference organised by VNO-NCW in Scheveningen, Netherlands, on 5 November 1999.

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1. Introduction

Your Majesty, ladies and gentlemen,

It is a great pleasure for me to be here in Scheveningen today and I should like to congratulate VNO-NCW on its hundredth anniversary. I have met less healthy centenarians. I should also like to thank Hans Blankert for my pleasant cooperation with him in my former position, and I should like to wish his successor, Jacques Schraven, every success.

Since 1 January 1999 the euro has become a reality. As you know, the euro area experienced a slowdown in economic growth in the early part of the year. Fortunately, the recovery is now under way. The challenge posed to policymakers, but also to entrepreneurs like many of you, at this juncture is to ensure that the cyclical recovery is the beginning of a long period of growth without inflation. As regards the economy of the United States, there has been extensive debate on the question of whether the United States has entered an era of a “New Economy”. Growth would be sustainably higher than in the past, inflation would be a thing of the past, while economic fluctuations would be much more limited than formerly. The cause of all this would be the boom in information technology. However true this may be for the United States, for Europe the “New Economy”, particularly in a macroeconomic sense, is a goal rather than reality. This also holds for countries in the euro area, such as the Netherlands, which are performing relatively well. Growth is high here, but this cannot (yet) be said of increases in productivity. Inflation is on the high side, especially relatively speaking, and it is still too early to put the theoretical books on the economic cycle away on the shelves forever.

However, I do not want to sound pessimistic. Europe can become a dynamic economy. What is needed is the comprehensive administration of by now well-known prescriptions to get rid of old illnesses and to avoid old mistakes. This can improve the conditions for entrepreneurs to do what they are really good at: enterprise. Policy creates the conditions, but real growth has to come from entrepreneurial activities. Whether that will lead to a “New Economy”, we may discuss at a future anniversary. I should like to deal with monetary policy first, and subsequently with the other economic policy needed to allow Europe to use the potential which it certainly has.

2. The role of monetary policy: maintaining price stability

The euro is not and cannot be a cure for all of European problems. In particular, the introduction of the euro will not by itself solve the unemployment problem and automatically increase growth. The single monetary policy can provide a sound basis for economic growth and employment, but the degree to which the economic potential of the euro is realised depends first and foremost on accompanying stability-oriented fiscal and appropriate labour market policies. Let me start by elaborating on the role of monetary policy.

Among central bankers and economists, overwhelming agreement exists that there is no long-run trade-off between real activity and inflation. Attempts to use monetary policy to raise real economic activity above its sustainable level will, in the long run, simply lead to ever higher inflation, not faster economic growth. The best contribution which monetary policy can make to sustainable growth and employment in the euro area is to maintain price stability in a credible and lasting manner, allowing the considerable benefits of price stability to be reaped over the medium term.

It is also generally acknowledged that monetary policy does indeed affect real activity in the short run. Although the focus must always be on price stability, in many cases the policy action required to maintain price stability will also help sustain short-run economic and employment prospects. However, in situations where monetary policy might face a short-term trade-off between adverse developments in real activity and deviations from price stability, the overriding priority accorded to maintaining price stability must be made absolutely clear. Any ambiguity on this point will simply endanger the credibility and thus the effectiveness of the monetary policy response. The medium-term orientation of the Eurosystem's monetary policy strategy permits a gradualist and measured response to threats to price stability. Such gradualism helps to avoid the introduction of unnecessary uncertainty into the real economy.

3. Non-monetary policies: stability and reform-oriented

The full benefits of the single currency will arise only if there is appropriate support from a variety of other policy areas, above all national fiscal and labour market policies, and if structural reforms are carried out in these areas. Price stability is a necessary, but not a sufficient condition for grasping all the opportunities of EMU.

What role can national governments still play, now monetary policy has been centralised? A very important one. A single monetary policy requires variation in other policies. It is of the utmost importance that national governments continue to implement fiscal policies that aim at a budgetary position close to balance or in surplus, as stipulated in the Stability and Growth Pact. If governments achieve balanced budgets or surpluses in normal periods of the cycle, they create a safety margin, sufficient to allow the operation of automatic stabilisers in the event of fluctuations in growth without risking excessive deficits. Moreover, sound government finances are important to strengthen the conditions for price stability and for the strong and sustainable growth necessary to support employment growth.

Structural policies are another key area where national flexibility is needed and a uniform approach would be fatal. Many of the important challenges which the euro area countries currently face can only be addressed through national policies. This concerns in particular the high and persistent level of unemployment, which is rightly a source of deep concern. Clearly, the approaches that are most likely to have a lasting effect are those that address the root cause of the problem, not the symptoms. The root causes of high and structural unemployment in the euro area are structural rigidities in labour markets as well as tax and public transfer policies.

The situation in euro area labour markets differs considerably. National unemployment rates range from 2.8% in Luxembourg and 3.2% in the Netherlands to 15.7% in Spain. Some countries, particularly those with more flexible labour markets, more moderate wage increases and better tax and social security policies, have managed to avoid the trend of ever-rising unemployment. For example, the Netherlands, Ireland and Portugal all currently show unemployment rates well below the euro area average. There are also examples of other countries with higher unemployment rates, such as Spain, that have begun to take steps to reform their labour markets and are now beginning to see tangible results. We can also look at some of the non-participating EU Member States, such as Denmark and the United Kingdom, to see that high unemployment can be reduced through structural reforms.

There are many examples of what can be done. First, there are measures to ensure that low-productivity workers are not forced out of the labour market. To this end, the burden of taxes and non-wage labour costs could be reduced for low-paid workers. In addition, minimum wage schemes and wage agreements reached by collective bargaining need to take account of the need to preserve jobs for low-productivity workers by reducing labour costs. Second, there are "active labour market measures" which provide programmes of education, training and work experience targeted at the long-term unemployed. Third, reforms to the tax and benefit systems could be implemented which ensure that people are significantly better off in work than out of it.

I should like to emphasise that the structural reform agenda available to national governments to promote economic development extends well beyond the reform of labour markets. For example, national governments can take steps to promote entrepreneurship and make it easier for people to start and run businesses and thus create new jobs. This could involve encouraging competition through measures to promote the entry of new firms, such as reducing the administrative burdens they face and making markets more competitive. Governments can also liberalise previously highly regulated sectors, such as utilities, to increase efficiency and reduce prices to the benefit of industrial and household users of these services. National governments may also wish to take steps to raise productive investment in research and development to increase growth in expanding high-tech industries.

Experience in the Netherlands shows that reform programmes indeed have the potential to substantially improve the labour market situation. The decline in the unemployment rate from its historical peak at 11.6% in 1983 to today's 3.2% is indeed impressive. However, even in the Netherlands there is little reason to become complacent. Thus, there seems to be a need to step up efforts to reduce inactivity and improve the flexibility of the labour market in order to help ensure responsible wage developments and price stability. It would also seem that the Netherlands has not, as yet, been successful in increasing output growth. A "polder model" yes, a "New Economy", no, not yet.

4. Conclusions

To conclude, I am convinced that Economic and Monetary Union provides a great opportunity to create and maintain a large zone of price stability and economic prosperity in Europe, including a substantial reduction of unemployment. However, while price stability is a necessary condition for fully grasping the opportunities of EMU, it is not sufficient. Stability-oriented polices regarding the development of national fiscal positions and structural changes to improve the functioning of markets are of crucial importance as well. Policymakers in all areas must take the new environment of Stage Three of EMU and its consequences appropriately into account when forming their policies. Only then will the euro be able to function as a true accelerator of economic growth in Europe.

The introduction of the euro and a common monetary policy have certainly not rendered national governments impotent. With the possibility to vary fiscal policy and undertake structural reforms, national governments retain the key powers to improve the performance of their economies. If the terms of the Stability and Growth Pact are adhered to, there is sufficient flexibility to allow automatic stabilisers to work in the event of cyclical fluctuations. Together with the social partners, governments have a key responsibility to act decisively to ease the unemployment problem in Europe. Structural reforms provide the only means of achieving lasting reductions in unemployment, preparing for the ageing of the population and reducing the burden of government debt.