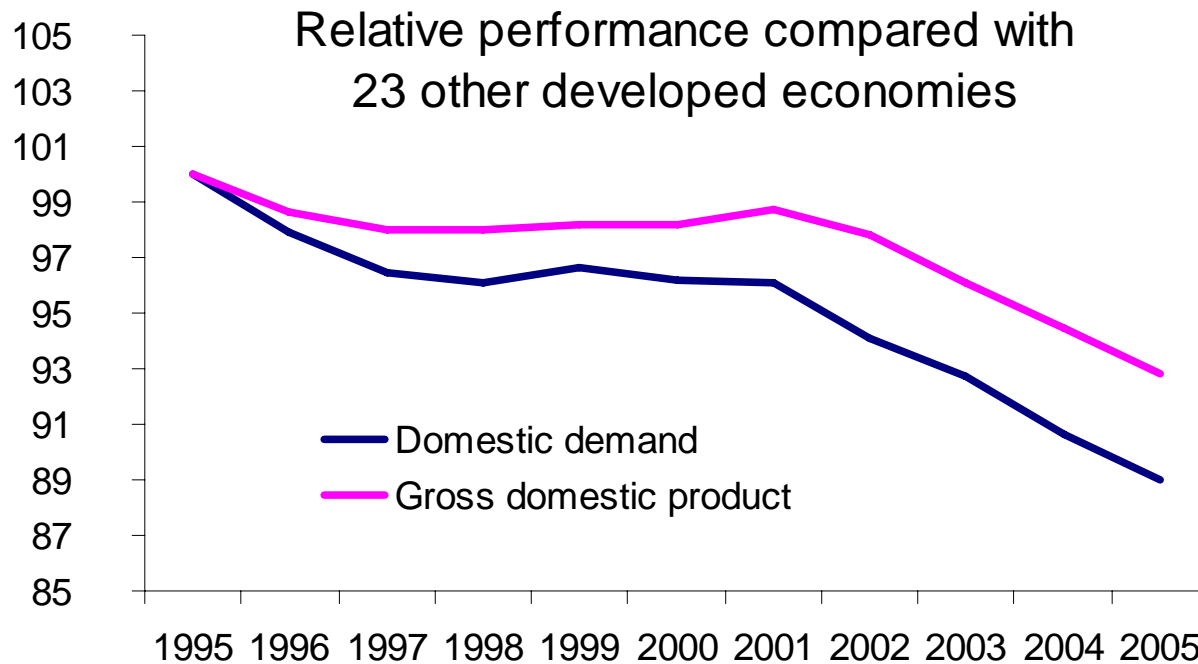


## What's wrong with the euro area economy?



# A lack of activism in macro policies ?

Does not really stand up to a close look...

Annual standard deviation - 1995-2005

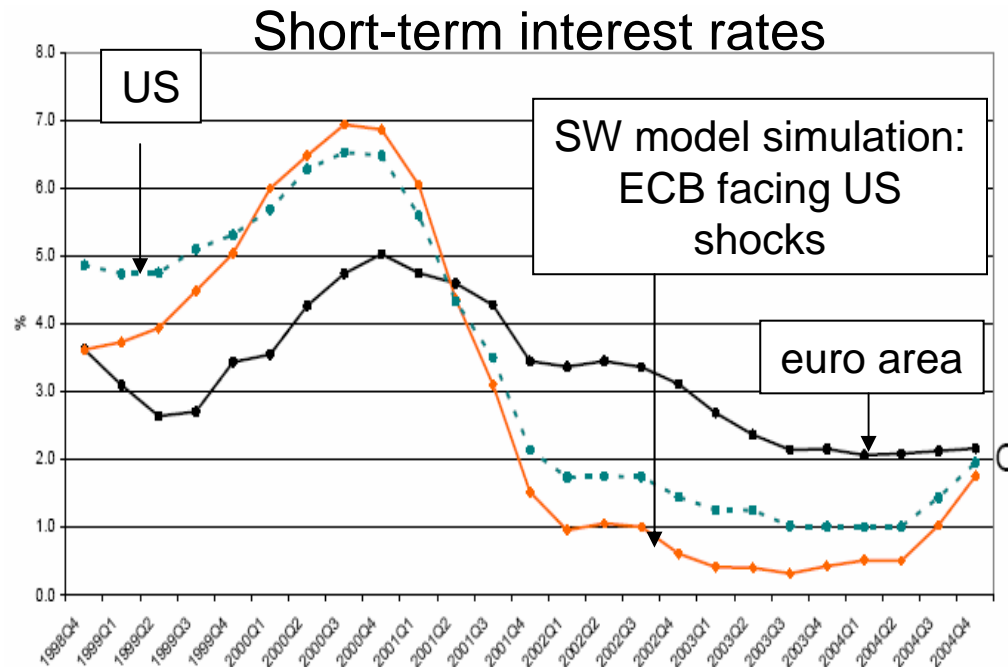
	Interest rate	Fiscal balance	Output gap
Euro area	1,4	1,2	1,1
US	1,9	2,4	1,7

1) Macroeconomic volatility is not higher in the euro area



# A lack of activism in macro policies ?

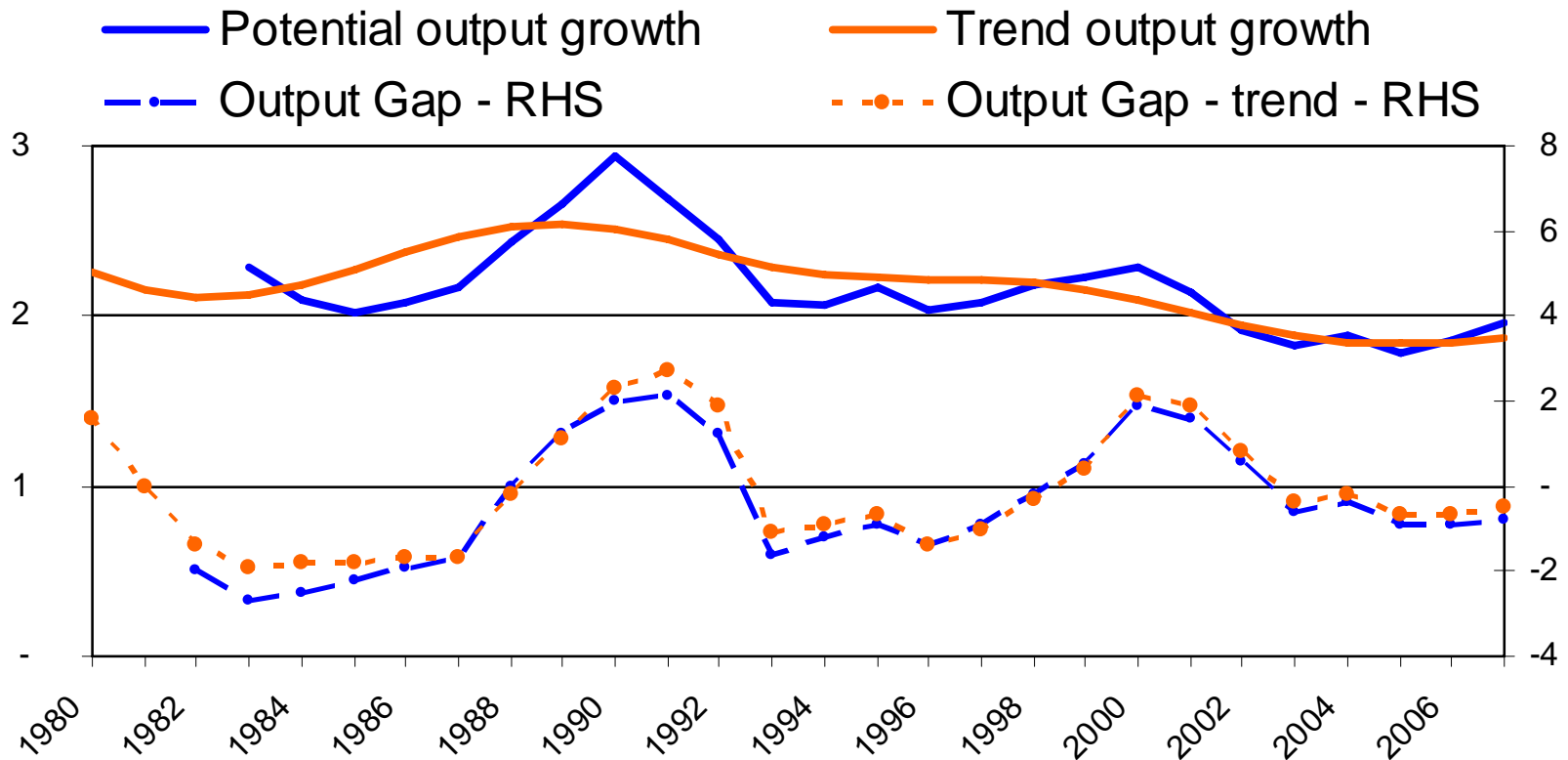
2) ECB behaviour is in fact quite similar to the FED



3) Fiscal policy: automatic stabilisers have played their role  
A deterioration in structural deficits would not have helped

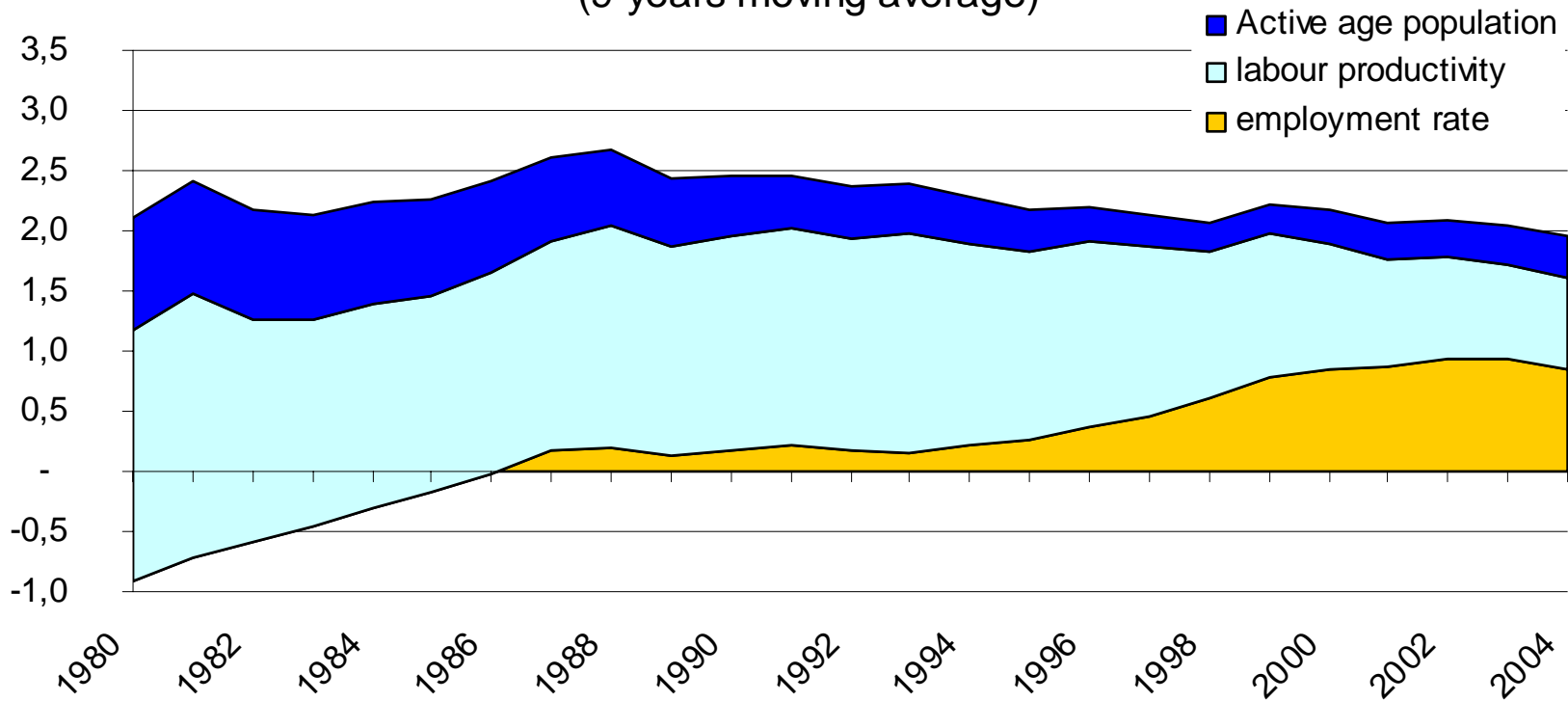


# The main issue: euro area potential output growth is uncomfortably low...



# The main reason: a deceleration in labour productivity...

Breakdown of real GDP growth  
(9-years moving average)



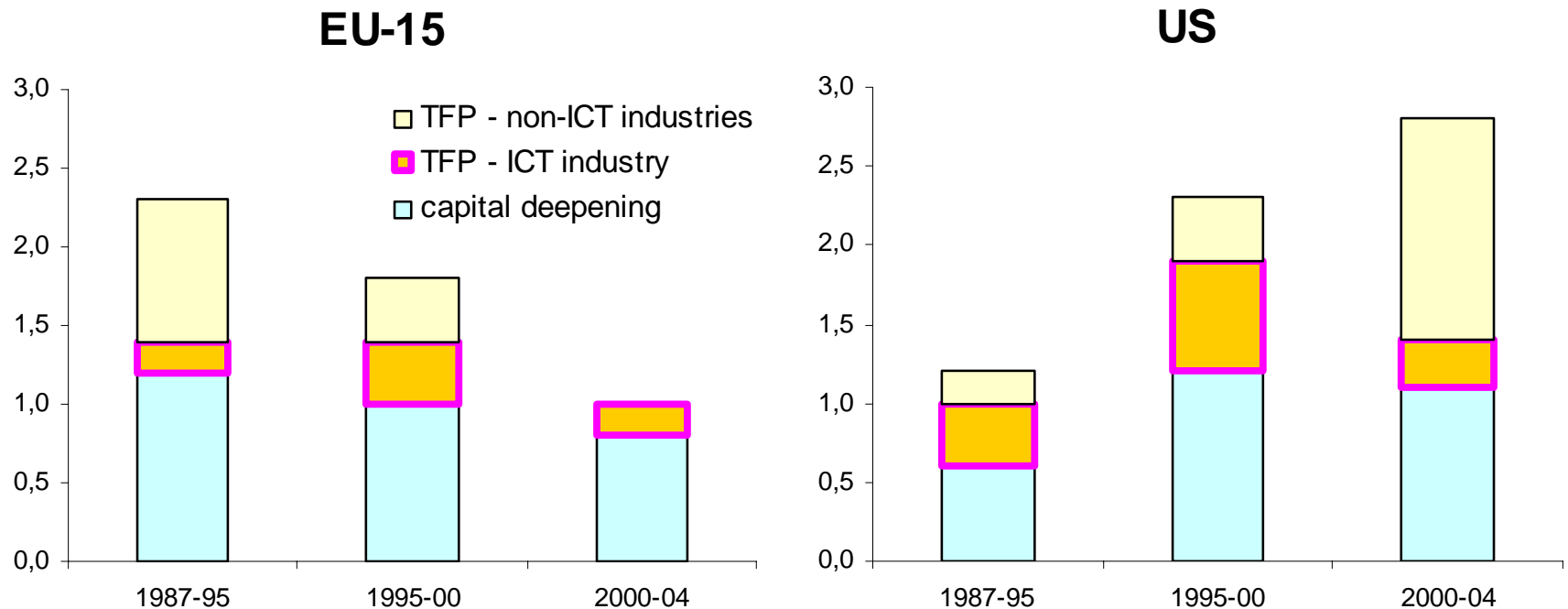
# This regime of low productivity growth is...

- Reducing economic expectations => low investment, low income, high savings (especially given still high unemployment)
- Hurting external competitiveness => loss of export market shares despite relatively modest wage growth
- Making the economy more fragile to external shocks (e.g. oil prices in 2005)
- Reducing the manoeuvrability of macro policies (inflation is never far away)
- Making ageing and the adjustment of social systems more painful (also contributing to high savings)



# What's behind the productivity slowdown?

## Breakdown of hourly labour productivity growth Capital deepening vs Total Factor Productivity (TFP)



Bart van Ark (2005): "The overall picture points in the direction of regulations hampering productivity growth in services in Europe."



# ICT, entrepreneurship and human capital are crucial to foster productivity...

TFP acceleration and the business environment  
- correlation across OECD countries -

	Entrepreneur -ship	Human capital	ICT
TFP (from 80s to 90s)	0.4	0.6	0.6

⇒ Time to take Lisbon more seriously / unleash productivity and growth in the services sector

Question: can the macro-policy framework be more supportive of the reform agenda ?



# Time to take Lisbon seriously...

- **Put National Reform Programmes into practice**
  - Innovation, education and flexibility: the key priorities at national level
  - The NRPs are generally of good quality. They identify the right reforms responding to national challenges. But, it is more a collection of existing measures than new initiatives
  - Actual implementation will be the key. What sort of multilateral surveillance will be agreed upon ? => Spring Summit will be decisive
- **Complete the internal market for services**
  - Huge potential for growth and jobs (will boost productivity and employment). Van Ark: regulation in services sector is preventing the efficient use of ICT. We could miss a huge opportunity !
  - Services directive: where do we stand...
  - Financial liberalisation also important: reduces macro-economic volatility
- **Build a more business-friendly environment**
  - Continue better regulation initiative (e.g. REACH), reduce taxation, etc.
  - Better access to financing (notably for SMEs) and venture capitalism are key to promote innovative activities, risk-taking and entrepreneurship
  - More efficient state aid regime for R&D and innovation



# Can the macro policy framework be more supportive of the reform agenda ?

- **The issue...**
  - Reform can involve short-term cost, distributive effects => risk of status quo bias due to political economy constraints
  - Reforms used to be triggered by crisis and supported by accommodative macro policies (the Netherlands, Finland, Sweden)
  - Recent OECD and IMF studies show that the reform momentum slowed down since EMU, mainly in large euro area countries (Elmeskov (2005) Debrun (2003)). Macro framework has removed some “sticks” and provides little “carrots”
  
- **New SGP introduces flexibility to accommodate reform agendas - welcome**
  - benefits of structural reforms on public finances could be frontloaded. Rationale: reforms can have a short-term economic cost and take some time to deliver their benefits.

**But:**

  - Excessive deficits in countries most in need of reforms imply limited flexibility today
  - Difficult to assess the future impact of reforms



# Can the macro policy framework be more supportive of the reform agenda ?

- **ECB should also be ready to accompany widespread reforms**
  - Without prejudice to price stability, ECB has a joint responsibility for sustainable growth and high employment

**But:**

  - Potential output growth is low and structural unemployment is high. Inflationary pressures might not be very far => there is limited room for manoeuvre
  - The euro area is not one but 12 economies: policy response cannot be tailored for one specific country => need a simultaneous reform effort across countries
- **ECB should nevertheless become more accountable**
  - ECB should accept a more vigorous debate (not about the mandate or strategy of the ECB, but about its analysis and the conclusions it draws from it)

**Question:** should the dialogue between politicians and the ECB be public ?

  - Eurogroup and ECB are exchanging views on a regular basis.
  - Overt political pressures are not necessarily helpful => independence of the ECB could be brought into question
  - The quarterly dialogue between the EP and ECB should be reinforced to become a real exercise in public accountability. But of course the EP does not have the legitimacy of the US congress!

