

**OPENING REMARKS AT THE EUROPEAN
SUMMER SYMPOSIUM IN MACROECONOMICS**

by

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(Roda de Bará, May 2002)**

It is a pleasure for me and for the *Banco de España* to hold the CEPR **Summer Symposium in Macroeconomics** for the sixth time here in *Roda de Bará*. Let me first thank the organisers of this workshop for their invitation to start the Symposium with these opening remarks.

As you all know the *Banco de España* is a central bank that has a particular interest in promoting links between academic research and monetary policy performance. This interest is mainly underpinned by the wish to promote rigorous analytical and empirical studies aimed at shedding light on problems that policymakers must address.

Before proceeding, I should mention that this is the first time the Symposium has been held since the cash changeover to the euro. This exceptional event seems to point towards a remarkable success of the monetary union process, despite the doubts raised by some researchers and

commentators. I feel that the enthusiasm shown by European citizens in accepting such a complex and ambitious project testifies to its soundness.

I will focus on three main points. First, I will refer to the current economic context as a starting point for addressing issues related to the business cycle, frictions -either real, nominal or financial- and monetary policy in a global and uncertain world. The second topic concerns technological growth. In particular, a key question we need to answer in order to evaluate the connection between technological innovations and productivity growth is why the same technologies have not allowed productivity in Europe and Japan to catch up with U.S. levels. I will try to do my best to link these issues with the agenda of this symposium. I will then say a few words about the challenges policymakers face as a result of the upcoming enlargement of the European Monetary Union.

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The challenge raised by the significant deterioration in the economic situation in the US and the euro area, after the terrible events of September 11 were a good illustration of the complexity of monetary policy analysis and decisions in a context of rapidly changing economic conditions. In fact, the joint reaction of monetary policies on both sides of the Atlantic may be seen as having speeded expectations of recovery, as has been particularly apparent on the financial markets. There is some sense in

arguing that some sort of economic policy co-ordination should be part of the institutional arrangements for the global economy in the near future. But this experience has also shown that, while it remains essential to move ahead with co-ordination in order to reduce vulnerabilities, it is also important to maximise the scope for policy flexibility in response to external shocks. And especially so given the disparities in the sources of growth and the business cycle between the U.S. and the euro zone.

In terms of achieving higher sustainable and stable growth, monetary policy has a clear role to play. The programme for this ESSIM is devoted to an extensive range of issues, but some sessions clearly fit into the analysis of the role of price and wage frictions, as well as financial frictions, on macroeconomic fluctuations and monetary policy design. The role played by financial market developments in the monetary policy transmission mechanism is still an open and controversial question. In particular, the wealth effect on consumption of fluctuations in stock market prices and in other asset prices, such as housing, is a particularly relevant element for understanding differences between the US, the UK and the euro area.

Distinguishing between movements in these asset prices attributable to movements in the fundamentals rather than to bubbles matters for an efficient economic policy design. Investment allocations in a global economic set-up may be affected not only by differences in rates of

return but also by speculative movements giving rise to financial stress and economic policy problems.

In particular, the role of news -consumer psychology is pivotal to the timing of the recovery- and expectation formation can also interact with price and wage frictions, thereby constituting elements that should be combined in the design of an optimal monetary policy reaction to both domestic and external shocks. Hence, including these types of analyses is certainly worthwhile, and I hope that the discussions during the symposium can shed light on some of the issues that are crucial for understanding the business cycle and, by extension, monetary policy design in modern economies.

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As I said, a key question we need to answer in order to evaluate the connection between technological innovations and productivity growth is why the same technologies have not allowed productivity in Europe and Japan to catch up with U.S. levels. While productivity in some industrial countries other than the United States appears to have accelerated in recent years, a significant gap between U.S. productivity and that in other main areas remains.

One hypothesis is that a necessary condition for information technology to increase output per hour is the readiness to dismiss or re-train

workers that the newer technologies have made redundant. Countries with less flexible labour markets than the United States may have been inhibited in this regard.

Another hypothesis is that regulations, systems of corporate governance, trade restrictions and government subsidies have reduced the role of competition in inducing firms in Europe and Japan to take full advantage of the efficiencies offered by the latest advances in information technology and other innovations.

Further investigation will be necessary to evaluate the importance of these possible influences. But at this stage, one lesson seems reasonably clear. For an economy experiencing rapid technological progress, the flexibility of the labour and capital markets plays a crucial role in promoting the ongoing replacement of capital facilities embodying older technologies with facilities reflecting the latest innovations. Further reducing regulatory impediments to competition will, of course, enhance this process. The newer technologies have expanded the potential for economic well-being. Governments should seek to foster that potential.

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The CEPR has built up much-deserved prestige as a catalyst for academic research, so casting light on major challenges facing European economic policy. Thus, while there are good reasons to feel moderately

satisfied with the performance of the single monetary policy, we cannot ignore the challenges it must still address in order to continue fulfilling its mandate as effectively as possible. Allow me to address some of the most prominent challenges to which the CEPR analysts and researchers can hopefully contribute, with a view to shedding some light in the near future.

An initial challenge worth mentioning is of an analytical nature. We need to expand our capacity to better understand how the different euro area economies work and interact. In particular, in-depth work is needed on the analysis of the transmission mechanism affecting twelve countries once we take into consideration trade, financial and labour market linkages. Hence, an important question is whether the virtually certain enlargement of the euro area can be used to boost the supply-side reforms still pending in euro countries. This is something that should move in parallel with the convergence process of the accession countries in order to become members of the Monetary Union.

In addition to the urgent requirement to improve the statistical databases of the euro area, we must also make further progress in understanding the true impact of the structural change implied by the inception of EMU. This unique event has most likely changed the nature of important economic relationships in a way that we should be able to understand so as to evaluate with greater accuracy the actual transmission of policy actions to the economy. I think that a crucial avenue for future

analysis is the investigation of the macroeconomic implications and the likely course of economic divergences across countries within the euro area.

There are also some institutional challenges that merit further analysis. The single monetary policy is part of a complex institutional design in which responsibility for the different strands of economic policy lies with different economic authorities. Improving dialogue among these authorities, with full respect to their respective competences, is a permanent challenge. The Treaty establishes the basic framework for this dialogue. Under the Treaty, the President of the ECOFIN Council -and a member of the European Commission- are allowed to participate in the meetings of the Governing Council of the ECB, while the ECB President is invited to the ECOFIN and Eurogroup meetings. While this framework has proved useful in promoting dialogue, it might be worth thinking about how best to improve communication channels and the devices currently in place to ensure the appropriate representation of the euro zone in international economic fora.

Over the medium term, the most important challenge we will face is that posed by EU enlargement. Thus, there are some important principles that have to be balanced in the face of a bigger euro area. Some trade-offs may arise in the near future between efficiency, country size and federal representation in the European monetary policy decision-making process.

Since, as we expect, new countries will at some point meet the conditions to become full members of Monetary Union, the Eurosystem should be fully prepared. This involves a wide variety of aspects including, among others, the composition and functioning of the ECB government bodies and the development of new analytical tools to assess a new economic reality such as an enlarged euro zone.

All in all, the list of upcoming problems is clearly extensive and calls for a contribution by the academic community. The programme for this ESSIM is devoted to an extensive range of issues. Some differ from those previously noted but others are firmly rooted in the questions raised in my previous discussion of challenges for the euro area. We have what is perhaps a good opportunity to achieve results that may be used to guide economic policy decisions in the future. I am sure that you will seize it.