SPEECH/08/534

Joaquín Almunia

European Commissioner for Economic and Monetary Policy

Boosting growth and productivity in an open Europe

DG ECFIN Annual Research Conference - Centre Borschette

Brussels, 16 October 2008

Ladies and Gentlemen,

Every year, DG Ecfin's Annual Research Conference gives us the chance to hear cutting edge research and gain insight into the pressing questions in economic policy making. The topic for this year's conference, the role of international flows of goods, services, capital and labour in boosting growth and productivity, is one of the main priorities in these difficult times.

One could be forgiven for thinking that these issues are no longer relevant, now that financial issues dominate the debate. But looking beyond the very short term, we will have to reflect seriously on policies and strategies to boost growth and productivity.

We are living in a world that has completely changed from the economic point of view in the last year and, in particular, in the last month or so. The events since the collapse of Lehman Brothers equal the most damaging financial crisis since the 1930s. And they will come to be looked upon as a defining moment in the process of economic and financial globalisation.

The link between growth and economic integration has been widely debated. But with the crisis in financial markets, the global economy slowing, and the recent failure of the Doha negotiations, we can expect this already heated debate on the link between growth and international integration to become even more ardent. Even so, few would argue following this crisis that we can carry on with business as usual. We will need to reassess our economic and financial systems in an entirely new context.

The crisis has shown us very clearly that globalisation, as well as bringing economic benefits, can also transmit risk and volatility. There is no doubt that our highly developed, highly integrated capital markets have been an engine of economic growth over the last decade. But we are now seeing the consequences of their inadequate supervision and regulation. What is more, we have seen just how quickly a problem can spread from one small part of the financial system, the subprime loans, to every corner of the world.

This is not an argument for rolling back advances in financial globalisation. But we have to recognise the serious risks to economic stability and growth prospects of the current model. Our financial systems have proved highly vulnerable to liquidity and confidence problems and this vulnerability is passed on to our economies through lack of finance for households and businesses. Clearly the current model of leverage on which international financial markets are based has proved unsustainable.

Last weekend, the Eurogroup leaders agreed to react in a coordinated manner to secure the stability of our financial markets and banking sector in the short term. In the following days, more than a dozen governments have adopted financial rescue packages to implement these decisions. Right now the European Council is meeting near here and discussing measures to support financial institutions and protect depositors.

But we are facing a much longer term challenge. In the aftermath of the crisis, we will have to strengthen the financial architecture to improve the way we cope with the globalisation of financial flows. To some extent, we have already started with the ECOFIN roadmap of regulatory actions. But there is much more to do. This undertaking will take time. And its success will depend on whether we can learn the lessons of the last weeks.

We should not, however, forget the priorities we have defined before the onset of the financial crisis. Beyond the immediate financial sector problems, we face serious challenges to the real economy. There is no doubt that the financial crisis is impacting the non-financial sector - both households and businesses. This situation is compounding the effect of the oil and commodity price shocks that hit before the summer. Although these prices have eased since, volatility in energy and food markets are likely to characterise the global economy for some time and we cannot rule out that we may be facing an environment with durably higher energy prices. Given all this, there is a significant risk that potential output growth will be negatively affected in the time to come.

We also face the serious danger that the financial crisis and a cooling global economy give way to a surge in protectionism. A backlash against the openness that underpins growth and prosperity in our economies would be extremely damaging and would only aggravate economic downturn.

Hence your discussions today clearly couldn't come at a more important time. We will need comprehensive and targeted strategies for increasing productivity and growth in our economies. Not least because the long standing challenges to European growth have not disappeared and have become even more pressing.

Indeed, we cannot forget that we still need to prepare our economies for the challenges of ageing. On current policies, ageing is projected to more than halve growth potential in the EU by 2050. As the size of the workforce falls dramatically, productivity will become an even more critical source of growth.

Hence it is vital that we tackle Europe's relatively modest productivity growth, which has fallen behind other advanced economies over the last decade.

Boosting Europe's growth potential has now become even more crucial. It will be vital to secure our prosperity, support our social model and mobilise our ability to react to the challenges that confront us.

How then do we increase potential growth? There are two key channels: first by raising employment rates and second, by ensuring high and sustainable growth rates of total factor productivity.

In raising employment, up until now, Member States have seen some important successes. Since 1999, the European Union has created 17 million jobs, and our unemployment rate is now the lowest in 25 years.

On the other hand, results in terms of total factor productivity growth are not so clear and divergences between EU countries are wide.

One reason is that innovation and diffusion of technology – crucial elements for boosting TFP growth – are still lagging in the EU. Creating a genuine single market for knowledge, by removing barriers between top universities and research bodies, would be just one means to counter this trend.

More research is necessary in this field. Although we know that investment in research and development, human capital and quality of institutions are certainly important factors, it seems there is no obvious recipe for TFP growth.

Labour migration also has a part to play in boosting growth. Yet, when it comes to the role of international labour flows and economic growth, few issues are as controversial. Nevertheless, there is considerable evidence that immigration resulting from the 2004 enlargement brought important economic benefits for many Member States. Indeed, few economists would dispute the positive contribution that immigration can make to total output. Not only does it bring in more workers, but immigration creates more opportunities for growth and jobs in an economy rapidly adapting to change.

We need policies that encourage mobility by removing the legal, administrative and cultural barriers to working across European borders. Immigration of skilled workers not only can help alleviate labour shortages, but the increased return of capital resulting from the immigration of skilled people tends to create investment opportunities, especially in knowledge intensive sectors.

I have dwelled on two channels for boosting growth and productivity, but there are many more. Indeed, this conference provides a good opportunity to dig deeper into the determinants of growth in an open economy.

I hope that the high quality analyses presented over the course of today and tomorrow can shed some light on the growth differences across European countries. Only through deeper understanding of these causes can governments devise effective policies to boost TFP, encourage labour migration and increase growth.

Conclusion

Ladies and gentlemen, let me conclude.

In the current context, analysing the impact of international flows of goods, services, capital and labour is a central for understanding the functioning of our domestic economies and improving their performance. This is the task that awaits you over the next two days; to provide insight on how international flows affect European growth and productivity and to identify the policies that can boost growth through international flows. The current economic and financial climate as well as longer term challenges facing Europe couldn't make your work more relevant and necessary. I wish you a fruitful two days of discussion.