4. ACTUALITES

12 January 2007

Seminar on structural reforms

Introduction

On 12 January 2007, Governors Nicholas Garganas, Bank of Greece, Guy Quaden, Banque nationale de Belgique and Yves Mersch, Banque centrale du Luxembourg, held a conference organised by the BCL on the important topic of structural reforms. In this Bulletin we publish the speeches of the three governors as well as a summary of the question and answer session with the journalists.

From left to right: Governors Quaden, Mersch and Garganas.

Structural Reforms in Europe: Harmonisation or Decentralisation?

Introduction by Yves Mersch, Governor of the Banque centrale du Luxembourg

A framework for discussion

I would like to welcome Governors Quaden and Carganas. They will highlight the salient structural reforms implemented in their respective countries and insist on many national achievements that could be emulated in other European countries from a "best practice" perspective. Both of them will also address the debate "harmonisation versus decentralisation" per se. In order to provide a framework for the ensuing discussion, I will endeavour to clarify the concept "structural reforms" and to underline the multiple interactions between the different reform areas. I will then turn to the harmonisation/decentralisation issue.

1. Definition and a tentative typology of structural reforms

Let me mention the following definition of structural reforms by the IMF[2]: "*Structural reforms entail measures that, broadly speaking, change the institutional framework and constraints governing market behavior and outcomes*". The IMF also notes "*the term is often used interchangeably with deregulation*". The concept of structural reforms could also conceivably be extended to measures not directly related to deregulation or to the smooth functioning of the market economy, but related to investments in human capital, to the enhancement of research, transport and environmental infrastructure. Improved public governance is also of paramount importance.

Structural reforms can be further specified based on a tentative typology centred on the areas where reforms are particularly needed:

Reforms related to public finance

The ultimate target of such reforms is the attainment of fiscal sustainability. This could be partly achieved with short-term measures of a more "tactical" flavour or, at the opposite end, with structural changes per se. Structural changes could be for instance adjustments in retirement ages, transition from PAYG to funding or removal of tax distortions. This could also include decisive changes in the institutional environment, for instance the setting up of independent budgetary institutions such as the "Conseil Supérieur des Finances" in Belgium.

Some measures are in an intermediate position, like the so-called "parametric reforms". Let me mention for instance adjustments in the indexation of pensions to prices or to real wages.

Reforms related to the labour market

Labour market reforms are mostly a national matter in the EU, although the Lisbon strategy enhances international cooperation in this field. These reforms could pursue a variety of different objectives, namely (i) decreasing structural unemployment, (ii) alleviating some pressures to public finances – such as the budgetary cost of early retirement, (iii) ensure that wage increases are in step with productivity growth, (iv) improving the qualification of the labour force via education or research & development and (v) more generally, enhancing GDP growth and productivity, especially in the context of population ageing.

2 *IMF (2004), "Fostering structural reforms in industrial countries", World Economic Outlook 2004, Chapter III.*

This is an area where national regulations or procedures – such as wage bargaining processes – are particularly well entrenched. According to Saint-Paul (2004), the average level of wage mark-ups would have hardly changed in the EU during the 1990s.[3]

Reforms related to product markets, including financial services

This essential reform area encompasses the removal of price controls, reduced public involvement in production, lower trade barriers and more flexible entry and exit rules.[4] Deregulation and enhanced competition were driven by several EU directives as regards for instance telecommunications, energy markets, transports, postal services, financial markets and VAT – in line inter alia with the "Internal Market Strategy". However, national practices are still disparate in this field, as regards for instance entry barriers as well as entrepreneurship and administrative regulations.

Accordingly, EU countries still differ markedly in the average size of price mark-ups according to Everaert and Schule (2006)[5], in particular as regards services. A recent OECD survey[6] shows that product market deregulation in Europe could boost GDP growth. For instance, multifactor productivity could increase by about 0.6% and 1.1% a year over a period of 10 years in Belgium and Greece, respectively, in case their regulatory stance would be aligned with the ones of the less regulated OECD countries.[7]

2. The many complementarities between reform areas

It is also essential to take note of the interrelationships between the different types of structural reforms. It is easy to understand that labour reforms have a positive impact on the sustainability of public finances, owing to their favourable impact on the contributors-to-pensioners ratio. But let me mention two salient but less intuitive complementarities:

- Everaert and Schule (2006) argue that "*synchronizing the timing of product and labor market reforms would mitigate the downward effect on real wages*". Product market reforms would induce lower consumer prices. This would alleviate the adverse short-term impact of labour market reforms on the purchasing power of households. The implementation of such reforms would therefore be smoother.

- Public finance reform could also ease the implementation of other structural reforms. As noted in the IMF 2004 World Economic Outlook, a strong fiscal position makes it possible to compensate people who stand to loose from structural reforms. Compensation undermines the resistance to reform, but sound public finances are a prerequisite for such a move. The IMF identifies a particularly strong positive association between tax and labour reforms, as was illustrated by the reform process in the Netherlands in the nineties. To support wage moderation, taxes and social security contributions were decreased during this period. In order to finance this supportive tax package, primary government expenditure was managed in a very rigorous way.

As noted in Hoj, Galasso, Nicoletti and Dang (2006, op. cit.), "*the sequencing of and interaction among reforms tend to differ from country to country – at least to some extent – depending on economic and social institutions and traditions, and reflecting specific political economy factors*". This sentence is an excellent introduction to the central topic of the conference, namely "Enhanced harmonization versus decentralisation of structural reforms.

3 *Saint-Paul, G. (2004), "Did European Labour Markets Become More Competitive in the 1990s ? Evidence From Estimated Worker Rents", CEPR Discussion Paper 4327.*

4 *The latter would be the top priority according to the EU Economy 2005 Review (European Commission).*

5 *Everaert, L. and Schule, W. (2006), "Structural reforms in the euro are: economic impact and role of synchronisation across markets and countries", IMF Working Paper WP/06/137.*

6 *Nicoletti, G. and Scarpetta, S. (2005), "Regulation and economic performance: product market reforms and productivity in the OECD", OECD Economics Department, Working Paper n°47.*

7 *Nicoletti, G. and Scarpetta, S. (2003), "Regulation, Productivity and Growth", Economic Policy, Vol.36, pp. 11-72.*

3. Enhanced harmonisation versus decentralisation of structural reforms

Two opposing lines of arguments could be mentioned in this respect:

Harmonisation presents several **advantages**. In my view, they are numerous and they are at the same time multi-faceted:

- Coordination would enable European countries to avoid "Beggar-thy-neighbour" types of reforms. Although they could make sense from a purely national viewpoint, stand-alone measures usually lead to suboptimal results at the European level. The coordination of reform processes between countries would internalise the favourable spillover effects of reform.
- The aforementioned complementarities between reforms call for a better coordination between the national and the European level. This is for instance the case as far as product (to a large extent an EU responsibility) and labour market reforms (which usually belong to the remit of national authorities) are concerned.
- Harmonisation of reforms would magnify the favourable impact of reforms on GDP growth and productivity. According to Everaert and Schule (2006), who used the IMF's Global Economic Model, a gradual alignment of Belgium to the lower mark-up levels observed among EU countries on the goods, services and labour markets would result in real GDP being 11% above the baseline. This "growth dividend" would further and significantly increase in case deregulation would be coordinated with the rest of the euro area.
- As stated by the same authors, goods, services and labour market reforms would cause inflation to decline at the beginning of the reform process. This would translate in higher real interest rates in countries where reforms are implemented on a stand-alone basis. The nominal interest rate would indeed hardly change, since it is set at the euro area level. Higher real interest rates in reforming countries would dampen the favourable impact of reforms on investment and consumption, which would result in a "reform trap". Should the same reforms be undertaken in the euro area as a whole, nominal interest rates would decrease in line with inflation and fall sufficiently to prevent the transitory economic slowdown. Everaert and Schule (2006) argue *"with stand-alone reforms, consumption in France would be 2.7 percent below baseline in the first year and investment 3 percent above. With synchronized reforms, consumption would be 5 percent above baseline and investment almost 8 percent"*. Pisani-Ferry and Sapir (2006)[8] also highlighted this "euro area dimension" of the coordination of reforms.
- Governments may learn from reforms undertaken in other Member States. This can be enhanced by benchmarking initiatives. In addition, as noted in the IMF 2004 World Economic Outlook, international arrangements are useful as commitment devices in the face of resistance against reforms.
- Harmonisation would enable countries to take advantage of scale or scope economies or of enhanced labour mobility, for instance as regards research expenditure and education (see for instance the mutual recognition of university degrees).
- The coordination of structural reforms in the field of public finances would prevent that public finance indicators go astray in the different EU countries, due for instance to disparate increases in pension or healthcare indicators. As indicated in the EPC/European Commission report on ageing, social transfers are likely to increase much less in reform countries than in the other countries by 2050. In addition, enhanced coordination of pension reforms would ease the "portability" of pension systems across Europe, which would improve labour mobility.

8 *Pisani-Ferry, Jean and Sapir, André (2006), "Last exit to Lisbon", Bruegel Policy Brief, 2006/02, March 2006.*

Although harmonisation is on various accounts the best option, full harmonisation may decrease the efficiency-enhancing aspects of decentralisation. As stated in the **decentralisation theorem** of Oates[9], *"For a public good – the consumption of which is defined over geographical subsets of the total population and for which the cost of providing each level of output of the good in each jurisdiction are the same for the central government or the respective local government – it will always be more efficient or at least as efficient for local government to provide the Pareto-efficient levels of output for their respective jurisdictions than for central government to provide any specified and uniform level of output across all jurisdictions"*. This is due to the differences in tastes and preferences as regards the provision of public goods. If these differences are too disparate within the total population, it is then reasonable to define geographical subsets and to tailor the delivery of public goods to the specific needs of each subset. This decentralisation theorem provides a conceptual justification for the existence of local or state government within a given country (e.g. the Länder in Germany, the Regions in Belgium, the States in the U.S.) or for the national dimension within the EU. This lends some support to different rhythms or complexions of structural reforms across Europe. For instance, Pisani-Ferry and Sapir (2006) argue *"investment in research and education is essential for countries close to the technology frontier, but not for countries at an earlier stage of development"*.

The balance between the two principles is likely to depend to a large extent on the type of reforms considered, thus the importance of the typology I mentioned earlier. I am convinced that the two lines of arguments are not necessarily mutually exclusive, as was for instance illustrated by the Lisbon strategy and the "open method of coordination". The latter method is primarily based on benchmarking and the identification of best practices. It helped Member States to develop and improve their policies in areas not covered by the existing UE governance processes.

I am convinced the ensuing discussion will provide some more insights in this very interesting topic.

9 *Oates, W.E. (1972), "Fiscal Federalism", New York, Harcourt Brace Jovanovich.*

Seminar on structural reforms *12 January 2007*

Structural Reforms in Europe: Harmonisation or Decentralisation?

Speech by Guy Quaden,

Governor of the Banque Nationale de Belgique

I would like to thank my colleague Governor Mersch for giving me the opportunity to address this assembly, where I recognize a good many Luxembourg, Belgian and fellow European friends. They immediately bring to mind the close relations between our two countries, including close links on the monetary front for more than 80 years. I am pleased to see that these links have not been broken down within the wider European monetary union, which Luxembourg and Belgium have belonged to since 1999 and which expanded to 13 countries just a few days ago.

The theme of our discussion is obviously something that is at the heart of my preoccupations, and for several reasons.

Firstly, as an economist, understanding how the economy works and proposing ways of improving it, through structural reform, is almost a *raison d'être*.

Then, as a central banker, along with my colleagues in the ECB Governing Council, I put out a reminder of the need for structural reform each month, in the explanation of our monetary policy decisions. What might sound like the monetary authorities singing the same old song to politicians at little cost does in fact reflect the importance of the two-way interaction between monetary policy and structural reform.

On the one hand, by ensuring price stability in the medium term and making sure that inflation expectations are well anchored, monetary policy helps foster a macroeconomic environment that is more stable and therefore conducive to more growth and employment. The current low level of long-term interest rates is without a doubt largely attributable to the credibility earned through monetary policy. This achievement needs to be preserved; not least because it helps make structural reforms easier to implement.

On the other side of the coin, by improving the economy's capacity to adapt and raising the growth potential, structural reforms facilitate monetary policy-making. Therefore, my colleagues and I welcome the efforts that have already been made in areas where the benefits are only reaped in the long term, while political considerations tend to be rather short-term.

And lastly, as both a Belgian and European citizen, it seems quite legitimate to aspire to a society organized in such a way that everyone can put their talents to good use, be rewarded for their efforts, but also give and take a sufficient dose of solidarity, and live in a quality environment. Indeed, the overall objective of structural reform must be to raise the standard of living in a sustainable way for each of us today, and for generations to come.

I believe that the diagnosis for the European economy is already well known. Labour force mobilization is relatively weak in Europe – and this has certainly proved to be the case in Belgium – while productivity gains have slowed down, despite remarkable scientific and technological progress. In the light of these observations, there has been a consensus for several years now – under the influence of work carried out notably by the IMF, the OECD and the European Commission – on the need to stimulate labour market participation, reinforce the quality of the labour force, improve the functioning of markets in goods and services, including financial services, and step up the innovation effort. This strategy was endorsed by the governments of the European Union Member States at the March 2000 European Council in Lisbon.

I think we have to acknowledge that progress has been made, albeit at varying speeds from one country to another, but that there is also still a long way to go. European economies today are faced with many challenges. I am of course thinking of globalization of the economy, demographic shifts and climate change. The current improvement in the economic climate must not be used as an excuse for postponing reforms; on the contrary, it should be seen as an opportunity to put them into practice with even greater resolve.

My exposé will obviously not cover the whole issue of structural reform. Owing to time constraints, I will not go into nonetheless important topics like education and innovation. In line with what has been suggested, I would like to illustrate the subject of reform with some concrete examples drawn from my country's experience and pointing up encouraging progress, even though it is often still not enough.

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First and foremost, in Belgium's case, reforms were carried out in areas where they were deemed most urgent. Significant progress has been made towards improving the country's public finance situation, which had become unsustainable in the 1980s, and with wage-setting, taking account of the need to remain sufficiently competitive, because Belgium has such an open economy. Apart from these characteristics that are peculiar to the Belgian economy, reforms have also been started in the field of pensions and employment of the older age bands of the population.

1. On the public finance front, the results so far are quite satisfactory. Belgium brought down its budget deficit from 8 p.c. of GDP in 1992 to less than 3 p.c. in 1997, which was one of the conditions for joining the monetary union. With the exception of 2005, a year for which Eurostat considers that the government's takeover of a public enterprise's debt should be accounted for as non-recurring expenditure, public sector accounts have been in balance since the year 2000.

   Of course, a central banker must never let complacency creep in. So I make no secret of the fact that these results have been helped along a little by low interest rates, one-off revenues and, more recently, a favourable economic situation. On the other hand, I urge even greater ambition. For, in order to meet the cost to the budget of population ageing in the coming decades (healthcare, pensions, etc.), it is structural surpluses we should be showing as soon as possible.

   Even if it is advisable to further speed up the trend, the debt ratio, which reached a peak of 133.5 p.c. of GDP in 1993, has nonetheless been on a continual downward path since then and dropped below the 90 p.c. mark in 2006.

   The return to a sustainable long-term budgetary policy has been made possible thanks to credible commitments, based on the opinions of independent institutions.

   EU constraints and peer pressure have certainly served as an incentive, especially in the form of the multilateral surveillance system laid down by the Maastricht Treaty and then by the Stability and Growth Pact. European budgetary standards have been a powerful disciplinary tool in preparing for Economic and Monetary Union membership. They remain effective in that respect. They have also played a big part in persuading the public to accept the need for the adjustment process.

   To prepare the ground for its work on the budget, the Belgian government draws widely on the expertise and advice of independent national bodies. On the one hand, it has entrusted the National Accounts Institute with the task of preparing the macroeconomic forecasts which, in principle, serve as the basis for drawing up public budgets. On some occasions, the government has chosen to add a safety margin to these forecasts. Conversely, credibility factors effectively prevent it from taking into consideration a more favourable macroeconomic scenario than that published by the National Accounts Institute.

   In addition, and again acting independently, the High Council of Finance, in whose work the National Bank is involved, draws up recommendations for the course of the public sector borrowing requirement. These targets – certainly ambitious, but realistic all the same – have formed the basis for successive governments' budget plans. These recommendations go even further than strict respect for EU rules, since they take into account future requirements stemming from the ageing population. Moreover, the High Council of Finance, which also comprises experts appointed by the Communities and Regions, contributes to ensuring the necessary coordination between the various levels of power that make up the country's system of government. It effectively transposes the general objectives for all the public authorities into specific recommendations for each entity. These are given a formal setting in cooperation agreements between the federal government and the communities and regions, a sort of internal stability pact.

We could look at it as an example of good practice. Besides, the beneficial role of the NAI and the High Council of Finance in preparing the ground for consolidation of public finances is acknowledged in recent IMF and EC publications.

2. Unlike the budgetary procedures, the automatic wage-indexation mechanism used in Belgium meets with almost unanimous disapproval by the international institutions, because of the nominal rigidities it risks causing. Along with Luxembourg, Belgium is certainly in good company here, but we are quite isolated among the European countries, even if several of them have partial indexation systems. Are Belgium and Luxembourg right to go it alone or not? In my view, in the Belgian case the question calls for a carefully weighed-up response.

   The wage-indexation mechanism has been around for a long time in Belgium. The first collective agreements on the subject were concluded as early as 1920, notably in the mining industry, and, after a wage freeze during the second world war, they were widely reinstated at the end of it. The wageindexation mechanism has become an essential element of a wide social consensus, but at one time, it also risked undermining business competitiveness. Index-linking was also temporarily suspended following the devaluation of the Belgian franc in 1982.

   The need to keep a competitive edge led to a thorough reform in 1994. The government laid down a new requirement for the so-called health index to be used as a reference for indexation rather than the general consumer price index. A number of products like tobacco, alcoholic drinks, petrol and diesel are not taken into account in calculating the health index. In this way, any increase in taxes and excise duties on these products, especially tobacco and petrol, is no longer passed onto wages and prices and, on the other hand, second-round effects on wages from a sharp rise in oil prices are limited. This goes a long way towards explaining why, unlike what happened during the 1973 and 1979 oil crises, nominal wages have not been caught up in an inflationary spiral in recent years.

   No doubt driven on by the same desire for competitiveness, but also by the need to rein in public finances and inflation, I understand that the Luxembourg government also decided in spring 2006, after negotiating with the social partners in the tripartite coordination committee, to adjust the automatic indexation mechanism until 2009, by delaying the point in time when wages are indexed. And it decided to neutralize certain taxes, excise duties, fees and other contributions in the reference index for index-linking.

   While the indexation system, after being thoroughly reformed, remains an acquired right for both employees and for recipients of social benefits, the total development in private-sector wages has also been controlled since 1996 by the wage norm-another distinctive feature of the Belgian system. This indicative norm is set every two years by the social partners (employers and trade unions) in line with the expected evolution of hourly labour costs in the three main neighbouring countries (Germany, France and the Netherlands). It builds into the wage-formation process an explicit reference to the external situation and thus the competitiveness of the economy. It is a strong coordinating tool for negotiations at sectoral level. Among these sectors, the so-called "all-in" agreements, introducing a corrective mechanism in the event of higher indexation than anticipated during the negotiations, have mushroomed.

   All in all, I would say that if we didn't have wage indexation, we wouldn't have to invent it. But, taking account of the built-in control features, now keeping it within limits, indexation in Belgium is not – or to be more precise, is no longer – the bugbear still decried by so many international institutions.

3. On the other hand, I wholeheartedly share these same international institutions' opinion on the need to raise the rate of employment in Belgium. At just 61 p.c. of the population aged between 15 and 64, Belgium's employment rate is still noticeably lower than the average in Europe, not to mention other parts of the world. The boost it needs concerns, in particular, those groups that are under-represented on the labour market – young people, women, people of foreign origin and especially the relatively older groups of the potentially-working population.

   Raising the rate of employment among the over-55s is essential both to guarantee the financial viability of the legal pension system and to reinforce the economy's medium- and long-term growth potential. Quite paradoxically, the low rate of employment can be regarded as a pool of unused potential. However, tapping this potential is proving particularly difficult because the reforms we need to implement in this field frequently come up against strong resistance, from workers and employers alike.

   Action along these lines has already been taken in Belgium.

   As early as 1996, the federal government got down to tackling a major reform of the pensions regime for employees and the self-employed, by gradually raising the statutory retirement age for women, from 60 years at the beginning of 1997 to 65 on 1 January 2009. By then, it will be the same as the legal retirement age for men, which is helping to bring down the cost of population ageing. More women staying on in the labour force has also helped push up the employment rate among 55 to 64 year-olds, a rate which rose from 26 p.c. in 2000 to 32 p.c. in 2005, even though this is still very low.

   The exemption from seeking work granted to older unemployed people provided an important opening for early retirement from the labour market. The age limit for this exemption, which was set at 50 years until 2002, has been raised gradually to reach 58 in mid-2004.

   In 2005, the government launched another big reform whose main objective is to raise the employment rate among older people, above all by boosting the labour supply. It is known as the Solidarity Pact between the generations. The most significant measures concerned early retirement. This scheme has been used a lot from the end of the 1970s onwards, initially along with business restructuring efforts, but it quickly became widespread. At one time, the early retirement age was brought down to 55, and even to 50 in companies in difficulty or undergoing restructuring.

   These conditions have become unsustainable now that people are living longer and the population is ageing. The Pact brings the statutory early retirement age up to 60 years from 2008 onwards, with a seniority condition which will be gradually raised to 35 years. Various measures have also been taken to limit the use of early retirement schemes in the event of mass redundancies, notably by giving priority to active employment policies through outplacement and training. An employment cell must now be systematically set up in such cases.

   Moreover, the Pact has also established a framework to encourage people reaching the end of their career to keep their job or return to work. Financial incentives have therefore been introduced, including a new bonus system granting a pension supplement for people continuing to work after the age of 62. This should push up the actual retirement age itself.

   The Pact bears witness to an awareness and brings in an indispensable change of trend. According to the work done by the Study Group on Ageing set up within the High Council of Finance, it is a significant stage in the process, but still not enough in itself to bring the employment rate in Belgium up to a satisfactory level.

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Before summing up, I just have to say a few words about the question posed by the organisers of this debate to each of the contributors, namely, which is the best method: harmonisation or decentralisation? Do these few selected examples of measures taken in Belgium enable us to draw some lessons about the best strategy for continuing and speeding up implementation of the structural reform so badly needed by European economies?

First of all, I would point out that this reform applies to existing situations which differ radically from one country to another, even from one region to another. These specific characteristics, which can range from the institutional set-up to the labour relations and social security system, the structure of the economy or even the preferences of the various parties involved, must be taken into account when drawing up appropriate measures, likely to get sufficient backing from society at large.

Faced with these arguments in favour of decentralisation, we should not overlook the importance of the common approach developed at European level, in the context of the Lisbon strategy. Its contribution has been primordial in making structural reform a subject of national debate. The use of benchmarking and promoting "best practice" also come into this awareness-raising effort at national level. Furthermore, the European dimension helps reap the benefits of positive externalites factors stemming from close coordination of reform measures between countries, and helps keep the risk of possible "beggar-my-neighbour" policies to a minimum.

In the updated Lisbon strategy that they endorsed in 2005, the Member States and the EU authorities have put together a useful combination of a common and decentralized approach. The broad lines are drawn up at European level while the Member States are now given more responsibility in implementing reform measures.

Individual Member States mainly have their say by adopting National Reform Programmes, setting out government action in the fields of public finance, employment, the functioning of product and labour markets and promoting innovation. This joint process enables the European Union to take advantage of the positive interaction between structural policies. In the EU countries, notably in Belgium, drawing up these National Reform Programmes and implementing the reforms effectively requires close cooperation between the different levels of government (regional, national, European), as well as between public authorities and other stakeholders, and here I'm thinking particularly of the social partners, the academic world and society at large.

Within this framework, the national central banks also have a key role to play. One the one hand, they must back up the political decision-makers and the social partners by providing their macroeconomic and financial expertise. On the other hand, they have to keep the public informed of the grounds for and the need for the structural reforms.

Ladies and gentlemen,

The structural economic reform train in Europe is certainly on track. It now just needs a strong push, so that every citizen can enjoy a higher level of employment and well-being tomorrow.

Structural Reforms in Greece: An Overview

Speech by Nicholas C. Garganas
Governor of the National Bank of Greece

Ladies and gentlemen,

It is certainly a pleasure to address such a distinguished audience on the subject of structural reforms, an issue with important implications for the growth and prosperity of Europe. Indeed, in launching the Lisbon reform agenda more than six years ago, the European Council affirmed the crucial role of structural reforms in raising the growth potential of the EU economy. In what follows, I will share some thoughts on the recent Greek experience with structural reforms. In doing so, I will also touch on issues of wider interest.

Greece has made strong progress towards closing the gap in living standards with the more-advanced EU economies since the mid-1990s. Its annual average growth rate accelerated to around 4% in the last twelve years (1995-2006) from less than 1 % in the preceding 15 years (1980-94). As a result, Greece's per capita income (purchasing power standards) in relation to the average in the EU15 has risen from 64% in 1995 to 79% in 2006, according to preliminary estimates. This outcome does not take into account a recent upward revision of GDP since the year 2000 by about 25%, which is now being assessed by Eurostat.

The improved growth performance since the mid-1990s reflected, on the supply side, mainly favourable developments in labour productivity. Average annual productivity growth (as measured by growth in real GDP per employed person) accelerated to about 3% in the last twelve years (1995-2006) from around 0.5% in the preceding 15 years (1980-1994). Rising employment, largely related to an inflow of immigrants since the early 1990s, also contributed to output growth. The acceleration of productivity growth in Greece since the mid-1990s reflected both higher levels of investments and faster growth in total factor productivity, which were made possible by an improved macroeconomic environment and efficiency enhancing structural reforms.

The improvement in the macroeconomic environment was associated with a sharp decline in inflation during the 1990s – to around 2.5% by 1999, from an average of about 18% in the in the 15-year period ending in 1994 – and the adoption of the euro in 2001. Tight macroeconomic policies – including monetary, exchange rate, fiscal and income policies – since the first-half of the 1990s played a key role in bringing down inflation These policies enjoyed broad public support since they were widely understood as being pursued with a view to meeting the conditions for adopting the euro. Participation in EMU since 2001 has provided an environment of monetary stability and credibility.

Structural reforms in Greece proceeded slowly in the 1980s, but picked up considerable pace since the early 1990s. In the 1980s – when the economy was facing huge macroeconomic imbalances as a consequence of inappropriate macroeconomic policies – structural reforms were largely limited to the area of international merchandise trade in fulfilment of international trade treaties and obligations toward the EU, which Greece joined in 1981. From the early 1990s, the structural reforms were extended to selected product markets, chiefly telecommunications and the financial sector, which have subsequently exhibited dynamic growth. Users of such services are now seeing tangible benefits, including lower prices, wider choices, and innovative products. Some progress has also been made toward deregulating the energy market, strengthening competition in other product markets through the establishment of institutions to fight anti-competitive practices, improving the business environment, and alleviating some labour market rigidities. The domestic sea-transport sector was also liberalized in 2002. It is important to note that progress in implementing these reforms in Greece, as in other EU countries, was greatly facilitated by EU-wide negotiations and agreements on the Single European market and the adoption of the common currency.

Notwithstanding Greece's progress toward real convergence with the more advanced EU economies over the past 12 years, much remains to be done in terms of safeguarding macroeconomic stability and sustainable growth. Macroeconomic imbalances are reflected in the persistence of inflation afa relatively high level (11 % percentage points above the euro area average in recent years), and the large current account deficit (7% - 8% on average in recent years). While the inflation differential and the current account deficit can be attributed in part to the process of economic convergence, the size of the macroeconomic imbalances in the case of Greece will need to be reduced to ensure long-term financial stability, and sustainable and strong growth. Addressing the main underlying causes of the macroeconomic imbalances – namely the fiscal imbalance and the structural rigidities of the Greek economy – is especially important in the light of the challenges posed by population ageing, on the one hand, and globalization, on the other, for Greece's fiscal position and international competitiveness. Addressing these challenges will require, first and foremost, sustained further progress toward fiscal consolidation, including measures to put the public pension system on a sound basis. It will also require additional structural reforms to remove rigidities in the product markets and labour market, and to improve the business environment.

Fiscal reforms

Strong fiscal consolidation has led to a significant narrowing of the fiscal deficit over the past two years – to an officially estimated 2.6% of GDP in 2006, from 7.8% in 2004. Nevertheless, reflecting the accumulation at past fiscal deficits, the public debt remains excessively high at 104.3 % of GDP, the second highest in the EU. Moreover, the high level of the existing public debt does not capture the implications of population ageing, which will be especially severe in the case of Greece: in the absence of corrective measures, age-related government spending in relation to GDP is projected to rise by over 10 percentage points of GDP by 2050 i.e., by more than in any other EU15 country.

Fiscal consolidation will need to involve sustained adjustment with a view to achieving sizeable fiscal surpluses and a major decline in the public debt/GDP ratio.

This would require strict control of current spending, a widening of the tax base, and a curtailment of tax evasion, so as to also make room for a further reduction in the tax rates as well as adequate spending on public infrastructure and the growing needs of the ageing population. A strong fiscal position should also facilitate structural reforms by allowing the compensation of those who bear the cost of structural reforms, as the Netherlands, among a few other EU countries, have successfully done. Fiscal consolidation will need to be supported by a reform of the pension system that ensures its long-term viability.

Durable fiscal consolidation has thus far proved elusive. Achieving it could involve changes in fiscal institutions and practices. In this respect, it is useful to recall Greece's experience with fiscal adjustment in the 1990s. The fiscal deficit was reduced from an average of over 10% of GDP in 1980-94 to an average of about 5% of GDP in the latter half of the 1990s (3.4% in 1999). However, the fiscal adjustment was achieved through higher revenues and lower interest payments (stemming from the reduction in inflation and the adoption of the euro), rather than through control of primary spending, which, in fact, continued to rise in relation to GDP. In the event, this type of fiscal adjustment – which characterized some other euro area countries in the 1990s as well as Greece - - did not prove sustainable as evidenced by the subsequent rise of the fiscal imbalances in Greece and elsewhere in the euro area.

In these circumstances, institutional reforms that strengthen fiscal discipline – similar to those implemented notably by Belgium, Netherlands and Sweden – may be a key to achieving sustained fiscal consolidation. The institutional reforms in the aforementioned EU countries included the adoption of quantitative fiscal rules and improved transparency in the fiscal accounts, in conjunction with the establishment of independent and credible institutions responsible for assessing the design and implementation of fiscal policy. Finally, the reform of the pension system will require a public dialogue to ensure wide dissemination of the need for reform, including its implications for the viability of the pension system, as well as for the growth prospects of the economy.

Product/labour market reforms and improvement of the business environment

The majority of studies and surveys dealing with regulations and government controls in individual economies indicate that the Greek economy is more regulated than other euro-area economies. In a recent survey[10] by the Commission, Greece is ranked the fourth most restrictive regime among GECD members and the most restrictive among the 15 "old" members of the EU regarding product market regulation. This survey, which covers the years 1998-2003, shows that Greece is especially restrictive in the areas of state control of the economy and barriers to entrepreneurship. Although there was some significant improvement in all areas during the 5-year period under review, the pace of improvement was no faster than the average improvement of the other countries in the sample. An GECD study[11] has estimated that a more-efficient regulatory regime can raise the growth rate by three-quarters of a percentage point, on average, in GECD economies. For countries, such as Greece, that start with a relatively restrictive regulatory framework, the growth effect is considered to be even greater. Successive governments have tried to adopt a "one-stop shop" approach to new investments, whereby one authority is responsible for granting all the licenses required for new investments and for dealing with all regulatory issues. Considerable progress has been achieved in recent years, but more remains to be done.

Let me now turn to the area of labour market reforms. The need for such reforms is highlighted by Greece's low employment rate, which in turn reflects a high unemployment rate (still around 9 per cent) as well as a low labour force participation rate. Unemployment is particularly high among the youth and women. Enhancing the flexibility of the labour market is especially important in light of Greece's monetary union membership. A number of initiatives have been taken in this area at the legislative level, in terms of increasing the flexibility of employment and working time, reducing non-wage labour costs and upgrading labour force skills. Active labour market policies have been significantly improved since the early years of this decade. Again, more remains to be done. It will be important to deal with the still very significant burden of non-wage costs, mainly due to social security contributions, which are among the highest in Europe. There is also a need to modernise the education system and the vocational training systems so that they provide the skills that will enable workers to keep up with the changes in technology and market conditions, and also to improve the implementation of the active labour market policies.

According to the recent European Commission assessment of Greece's 2005-2008 National Reform Programme for Growth and Jobs, Greece is moving ahead relatively strongly in the macro-economic area, but needs to accelerate efforts in microeconomic and employment reforms. The Commission also identified several policy areas where priority needs to be given: reforming the pension system; modernising the public administration; increasing employment rates, modernizing employment protection and promoting labour mobility; and enhancing education and training.

A reality confronting any country implementing structural reforms is the fact that the costs of structural reforms tend to be narrowly concentrated and to appear upfront, while the benefits tend to be widely shared and to appear over the longer term. This situation tends to give rise to opposition to reforms by the particular groups adversely affected, while support for reforms often tends to be lukewarm, reflecting, in part, the fact that the fruits of reforms often take time to emerge. These considerations suggest that there is a need for a full social dialogue at home, in order to build consensus for reforms. In addition, coordination of reform policies within the EU would be helpful in diffusing knowledge about the reforms and overcoming resistance by affected groups in each EU country. Faced with a choice ranging between full harmonisation and full decentralisation of reforms, I would.' personally favour a strong form of harmonisation. EU Directives have certainly been instrumental in helping to push through important reforms in Greece, while the implementation of the Lisbon Strategy, an example of the so-called "open method of coordination", has so far been limited. More generally, I would be in favour of a broader scope for European Commission initiatives.

In the past fifteen years or so, Greece has confronted a succession of challenges. I am confident that the necessary consensus to achieve the remaining reforms will be achieved. I am, therefore, optimistic that Greece will not only maintain the living standards it has attained over the years, but will raise them.

Ladies and gentlemen, I thank you for your attention.

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10 *Conway at al (2006) and Commission of the European Communities (2006)*

11 *Conway, et al (2006).*

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Summary of Q&A session

Governor Garganas stressed that European monetary union had been extremely successful in terms of maintaining price stability and anchoring inflationary expectations, in spite of a number of important exogenous supply shocks. However, large segments of public opinion, notably in Greece, were convinced that the introduction of the euro had resulted in increasing the cost of living. In Greece, some price increases could be attributed to the poor functioning of markets. However, there was also a problem of perception, consumers paying more attention to items whose prices increased and which they purchased frequently, even though they might have a relatively low weight in their overall consumption basket, rather than to items which might have a higher weight in the consumer price index and the prices of which had decreased.

Moreover, in the case of Greece, some of the markets for goods and services were not functioning well and competition was lacking. Some companies took advantage of this situation to raise their prices arbitrarily. But the real problem here was the lack of structural reforms and certainly not the introduction of the euro, which had been a great success.

Governor Quaden fully agreed with Governor Garganas. In addition to an erroneous perception of increases in the cost of living, people had perhaps also believed that the introduction of the euro would automatically lead to higher growth and employment. The monetary policy of the Eurosystem had resulted in price stability and low interest rates, which were necessary, but by themselves insufficient, conditions for higher growth and employment. Structural reforms are needed to impact favourably on economic activity.

Turning to the debate harmonisation versus decentralisation, Governor Quaden observed that in the case of Belgium there were simultaneously one movement favouring decentralisation to the regional level and another favouring centralisation at the European level. He underlined the relevance to this debate of European directives, incentives and constraints. For instance, the Maastricht criteria proved useful in convincing the Belgian public that their country needed to address its fiscal imbalances. On the positive side of the euro, one could also take note of the fact that Belgium, and other euro area countries, were now involved in determining the Eurosystem's monetary policy, while prior to European monetary union these countries had followed an exchange rate policy vis-à-vis the DEM. Unfortunately, the Commission was often used as a scapegoat by national policy makers and this also led to a loss of popularity of the EU and its institutions among members of the public.

Governor Mersch pointed out that the population took for granted what had been achieved in terms of low interest rates and job creation but did not relate this to monetary union. He mentioned the example of transaction fees involved in transferring money from one European country to another. Before 1998, the Commission found out that if you initially had 100 USD and you changed the currency in twelve countries, nearly nothing was left when you had completed your travels round the twelve countries. This improved dramatically with the introduction of the euro.

Finally, it was only to be expected that the euro, as a successful catalyst of European integration, would be systematically criticised by those opposed to such integration.

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- Circulaire BCL 98/151 du 24 septembre 1998 – Aspects comptables du basculement vers l'euro
- Circulaire BCL 98/152 du 6 novembre 1998 – Introduction d'un système de réserves obligatoires
- Circulaire BCL 98/155 du 9 décembre 1998 – Rappel des obligations en matière de réserves obligatoires
- Circulaire BCL 98/156 du 21 décembre 1998 – Décomposition des corrections de valeur constituées par les établissements de crédit au 31.12.1998
- Circulaire BCL 99/157 du 17 décembre 1999 – Révision du pourcentage de déduction uniforme de la base de réserve
- Circulaire BCL 2000/158 du 25 février 2000 – Modification des tableaux statistiques S 1.1 «Bilan statistique mensuel» et S 1.2 «Bilan statistique mensuel simplifié»
- Circulaire BCL 2000/159 du 11 août 2000 – Application de quotités de valorisation de titres applicables aux titres éligibles «Eligibilité des créances privées néerlandaises »
- Circulaire BCL 2000/160 du 13 novembre 2000 à tous les OPC monétaires concernant l'adhésion de la Grèce à l'UEM
- Circulaire BCL 2000/161 du 13 novembre 2000 – Date de remise des rapports statistiques mensuels à la BCL
- Circulaire BCL 2000/162 du 13 novembre 2000 à tous les établissements de crédit concernant l'adhésion de la Grèce à l'UEM
- Circulaire BCL 2001/163 du 23 février 2001 – La surveillance par la Banque centrale des systèmes de paiement et de règlement des opérations sur titres au Luxembourg
- Circulaire BCL 2001/164 du 28 mars 2001 – Recensement du marché global des changes et des produits dérivés
- Circulaire BCL 2001/165 du 5 mai 2001 – Reprise des activités de l'Institut belgo-luxembourgeois du change par la Banque centrale du Luxembourg et le Service Central de la Statistique et des Etudes Economiques
- Circulaire BCL 2001/166 du 5 juillet 2001 – Instructions concernant les modifications de la collecte de données relative à la balance des paiements
- Circulaire BCL 2001/167 du 19 novembre 2001 – Dates de remise des rapports statistiques mensuels à la BCL
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- Circulaire BCL 2002/171 du 5 juin 2002 – A tous les organismes de placement collectif luxembourgeois – Modification des tableaux statistiques S 1.3 «Bilan statistique mensuel des OPC», S 2.10 «Ventilation par pays», S 2.11 «Ventilation par devises» et S 2.12 «Détail sur les titres détenus par les OPC»
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- Circulaire 2003 /180 du 11 juin 2003 – Enquêtes sur l'investissement direct étranger – A tous les établissements de crédit et aux services financiers de l'entreprise des Postes et Télécommunications (service des comptes chèques postaux)

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- Circulaire 2006/197 du 7 août 2006 – Adoption par la Slovénie de la monnaie unique, l'euro, à partir du 1er janvier 2007: Incidences sur les déclarations statistiques concernant la balance des paiements – A tous les établissements de crédit et aux services financiers de l'entreprise des Postes et Télécommunications (service des comptes chèques postaux)

- Circulaire 2006/198 du 7 août 2006 – Adoption de l'euro par la Slovénie – A tous les établissements de crédit

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- Bulletin BCL 1999/1, novembre 1999
- Bulletin BCL 1999/2, janvier 2000
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4.4 Publications de la Banque centrale européenne (BCE)

Pour une liste complète des documents publiés par la Banque centrale européenne (BCE), ainsi que pour les versions traduites dans les langues officielles de l'UE, veuillez consulter le site internet de la BCE **www.ecb.int**

For a complete list of the documents published by the European Central Bank (ECB) and for the versions in all official languages of the European Union, please visit the ECB's web site ***www.ecb.int***

Rapport Annuel de la BCE/ ECB Annual Report

- Rapport Annuel 1998/ Annual Report 1998, April 1999
- Rapport Annuel 1999/ Annual Report 1999, April 2000
- Rapport Annuel 2000/ Annual Report 2000, May 2001
- Rapport Annuel 2001/ Annual Report 2001, April 2002
- Rapport Annuel 2002/ Annual Report 2002, April 2003
- Rapport Annuel 2003/ Annual Report 2003, April 2004
- Rapport Annuel 2004/ Annual Report 2004, April 2005
- Rapport Annuel 2005/ Annual Report 2005, April 2006
- Rapport Annuel 2006/ Annual Report 2006, April 2007

Les Rapports annuels de la BCE (disponibles en français, anglais et allemand) sont diffusés gratuitement aux abonnés des publications de la BCL.

The ECB Annual Reports (available in French, English and German) are distributed free of charge to the subscribers of the BCL publications.

Bulletin mensuel de la BCE

ECB Monthly Bulletin

Articles parus depuis 2007/ *Articles published from 2007 onwards:*

"The enlarged EU and euro area economies", January 2007.

"Developments in the structural features of the euro area labour markets over the last decade", January 2007.

"Putting China's economic expansion in perspective", January 2007.

"Challenges to fiscal sustainability in the euro area", February 2007.

"The EU arrangements for financial crisis management", February 2007.

"Migrant remittances to regions neighbouring the EU", February 2007.

"Communicating monetary policy to financial markets", April 2007.

"Output growth differentials in the euro area: sources and implications", April 2007.

"From government deficit to debt: bridging the gap", April 2007.

"Measured inflation and inflation perceptions in the euro area", May 2007.

"Competition in and economic performance of the euro area services sector", May 2007.

"Determinants of growth in the EU Member States of central and eastern Europe", May 2007.

"Share buybacks in the euro area", May 2007.

"Interpreting monetary developments since mid-2004", July 2007.

"Oil-exporting countries: key structural features, economic developments and oil revenue recycling", July 2007.

"Adjustment of global imbalances in a financially integrating world", August 2007.

"The financing of small and medium-sized enterprises in the euro area", August 2007.

"Leveraged buyouts and financial stability", August 2007.

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Etudes ad hoc

Occasional Paper Series

Depuis 2007/*from 2007 onwards:*

"Globalisation and euro area trade: interactions and challenges" by U. Baumann and F. di Mauro, February 2007.

"Assessing fiscal soundness: theory and practice" by N. Giammarioli, C. Nickel, P. Rother and J.-P. Vidal, March 2007.

"Understanding price developments and consumer price indices in south-eastern Europe" by S. Herrmann and E. K. Polgar, March 2007.

"Long-term growth prospects for the Russian economy" by R. Beck, A. Kamps and E. Mileva, March 2007.

"The ECB Survey of Professional Forecasters (SPF) – A review after eight years' experience" by C. Bowles, R. Friz, V. Genre, G. Kenny, A. Meyler and T. Rautanen, April 2007.

"Commodity price fluctuations and their impact on monetary and fiscal policies in Western and Central Africa" by U. Böwer, A. Geis and A. Winkler, April 2007.

"Determinants of growth in the central and eastern European EU Member States – A production function approach" by O. Arratibel, F. Heinz, R. Martin, M. Przybyla, L. Rawdanowicz, R. Serafini and T. Zumer, April 2007.

"Inflation-linked bonds from a central bank perspective" by J. A. Garcia and A. van Rixtel, June 2007.

"Corporate finance in the euro area – including background material" by the Task Force of the Monetary Policy Committee of the ESCB, June 2007.

"The use of portfolio credit risk models in central banks" by the Task Force of the Market Operations Committee of the ESCB, July 2007.

"The performance of credit rating systems in the assessment of collateral used in Eurosystem monetary policy operations" by F. Coppens, F. González and G. Winkler, July 2007.

"Structural reforms in EMU and the role of monetary policy – a survey of the literature" by N. Leiner-Killinger, V. López Pérez, R. Stiegert and G. Vitale, July 2007.

"Towards harmonised balance of payments and international investment position statistics – the experience of the European compilers" by J.-M. Israël and C. Sánchez Muñoz, July 2007.

Etudes

Working Paper Series

La liste exhaustive des articles est disponible sur le site de la BCE, **www.ecb.int**, et dans le Rapport Annuel 2005 de la BCE.

A complete list of articles published is available on the ECB website, ***www.ecb.int*** *and in the Annual Report 2005 of the ECB.*

Brochures d'information

Information brochures

"The European Central Bank, the Eurosystem, the European System of Central Banks", May 2006.

"TARGET2-Securities brochure", September 2006.

"The Single Euro Payments Area (SEPA): an integrated retail payments market", November 2006.

Commande / *Order*

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4.5 Liste des abréviations / List of abbreviations

ABBL	Association des Banques et Banquiers, Luxembourg
AFN	Avoirs financiers nets
AGDL	Association pour la garantie des dépôts, Luxembourg
BCE	Banque centrale européenne
BCL	Banque centrale du Luxembourg
BCN	banque(s) centrale(s) nationale(s)
BEI	Banque européenne d'investissement
BERD	Banque européenne pour la reconstruction et le développement
BIS	Bank for International Settlements
BNB	Banque Nationale de Belgique
BRI	Banque des règlements internationaux
CAIL	Commission chargée d'étudier l'amélioration de l'infrastructure législative de la place financière de Luxembourg
CCBM	Correspondent central banking model
CEC	Centre d'échange d'opérations à compenser du système financier belge
CETREL	Centre de transferts électroniques Luxembourg
CPI	Consumer Price Index
CSSF	Commission de surveillance du secteur financier
DTS	Droits de tirage spéciaux
ECB	European Central Bank
ECG	Enlarged Contact Group on the Supervision of Investment Funds
EIB	European Investment Bank
EMI	European Monetary Institute (1994-1998)
EMS	European Monetary System
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
EUR	euro
EUROSTAT	Office statistique des Communautés européennes
FBCF	Formation brute de capital fixe
FCP	Fonds commun de placement
FDC	Fleur de coin
FMI	Fonds monétaire international
GAFI	Groupe d'action financière pour la lutte contre le blanchiment de capitaux
GDP	Gross domestic product
HICP	Harmonised Index of Consumer Prices
IADB	Inter American Development Bank
IBLC	Institut belgo-luxembourgeois du change
IFM	Institution financière monétaire
IGF	Inspection générale des finances
IME	Institut monétaire européen (1994-1998)
IMF	International Monetary Fund
IML	Institut Monétaire Luxembourgeois (1983-1998)
IOSCO	International Organisation of Securities Commissions
IPC	Indice des prix à la consommation
IPCH	Indice des prix à la consommation harmonisé

LIPS-Gross	Luxembourg Interbank Payment System – Gross Settlement System
LIPS-Net	Luxembourg Interbank Payment System – Net Settlement System
MBCC	Modèle de banque centrale correspondante
MFI	Monetary Financial Institution
NCB	National central bank
OCDE	Organisation de coopération et de développement économiques
OECD	Organisation for Economic Cooperation and Development
OICV	Organisation internationale des commissions de valeurs
OLS	Ordinary least squares
OPC	Organisme de placement collectif
OPCVM	Organisme de placement collectif en valeurs mobilières
OPEP	Organisation des pays exportateurs et producteurs de pétrole
PIB	Produit intérieur brut
PSC	Pacte de stabilité et de croissance
PSF	Autres professionnels du secteur financier
RTGS system	Real-Time Gross Settlement system
Système RBTR	Système de règlement brut en temps réel
RTGS-L GIE	Groupement d'intérêt économique pour le règlement brut en temps réel d'ordres de paiement au Luxembourg
SDR	Special Drawing Rights
SEBC	Système européen de banques centrales
SEC	Système européen de comptes
SICAF	Société d'investissement à capital fixe
SICAV	Société d'investissement à capital variable
SME	Système monétaire européen
SWIFT	Society for Worldwide Interbank Financial Telecommunication s.c.
SYPAL GIE	Groupement d'intérêt économique pour la promotion et la gestion des systèmes de paiement au Luxembourg
TARGET system	Trans-European Automated Real-time Gross settlement Express Transfer system
Système Target	Transfert express automatisé transeuropéen à règlement brut en temps réel
TCE	Traité instituant la Communauté européenne
UCI	Undertaking for Collective Investments
UCITS	Undertaking for Collective Investments in Transferable Securities
UCM	Union des caisses de maladie
UE	Union européenne
UE15	Etats membres de l'Union européenne avant le 1er mai 2004
UEBL	Union économique belgo-luxembourgeoise
UEM	Union économique et monétaire
USD	Dollar des Etats-Unis d'Amérique
VNI	Valeur nette d'inventaire