

“Eurosistem and Social Policy”

by Etienne de Lhoneux
Secretary General of the Banque centrale du Luxembourg

Contribution to the « Conférence sociale européenne des syndicats »

organised by the « Confédération Luxembourgeoise des Syndicats
Chrétiens » and « PRISMA-LUX »
Remich, 5 October 2007

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1 Introduction

First, I would like to thank Mr. Robert Weber for his stimulating introduction, as well as Mr. Léon Drucker and the organizers of this conference for inviting me.

Unfortunately for you, I'm not Mr. Trichet, President of the European Central Bank, neither Mr. Mersch, President of the Banque centrale du Luxembourg. They wished to be here today, but they cannot be because they are attending a meeting of the Governing Council of the ECB in Vienna.

It is for me a great privilege, but also a pleasure, to share with such a distinguished audience, some personal views¹ on a very interesting but delicate matter.

¹ The views expressed do not represent necessarily those of the Banque centrale du Luxembourg. The author wishes to thank warmly for their comments, his colleagues : MM. Michael Palmer and Muriel Bouchet, Mrs Simona Amati and Ulrike Götz

2 Central banks: evil genius or scapegoats? (mauvais génies ou boucs émissaires ?)

You've invited me to contribute to your discussions about the influence of central banks in social matters, in the European Union and in Luxembourg.

This is quite a challenge.

The relationship between central banks and social matters should be approached in a general context.

How social are banks? How social are central banks?

This refers to the basic issue: how social is the economy?

As a starting point, I wish to remember the ambiguity of the "social" concept.

We know that a "social" approach may have different interpretation. Do we seek an equal distribution of income, an increase of the global welfare or the protection of social benefits (droits acquis).

So one should not worry if different interpretations of the same concept lead to some contradictions.

We, central bankers, are not deemed to be true "social workers".

The traditional tasks of central banks are primarily aimed at contributing to the smooth functioning of the economy, which enhances the creation of value added. The redistribution of this value added is dealt with at a different, more "political" level. This functional dichotomy does not mean that central bankers are not interested in redistribution matters.

We all know that central bankers were not always the best friends of the trades unions. In front of you, I feel myself in the position of an accused.

Bankers are not always very popular; to be a central banker may be even worse.

A banker, at least, provides services to its clients, while central banks are dealing with macro-economic abstract subjects. Aren't they in Europe today, among these hated bureaucrats, contributing to a heartless global finance?

My professor of banking law, rather sceptical about the concept of voluntary social corporate governance, used to say that: "Un banquier face à sa conscience est en tête-à-tête avec le néant ».

History teaches us that it may dangerous to be a banker; shall I remember the Templiers under Philippe le Bel, King of France, or the tragic fate of the Lombards or of the Jews in Europe?

No doubt, the context has changed. Our economies are developing through the remarkable expansion of service industries. Among these, the financial services accounts for more than 10 % of the GDP, for more than 25 % in the case of Luxembourg. Who would dispute that the financial services are a major source of added value? So, to be a banker may be more fashionable today, but what about central bankers?

Do we need central banks?
We have still to provide evidence for it.
The art of central banking is still under development.

One may argue that central banks are called “old ladies” in England, Sweden or The Netherlands, where they were established some 300 years ago. However, their original function was different; they did not have, as today to conduct monetary policy independently. It was for the government to do it.

The Eurosystem is less than ten years old. For many European citizens, the concept of a truly independent central bank in charge of the conduct of monetary policy, in view of price stability is simply extraordinary and often still unacceptable.
This is why the question I have to answer is so tricky: how are central banks accountable vis-à-vis the social objectives of our democracies?

I like the challenge; if I’m the accused, I will try to defend the central banks in the hope of mitigating your final judgment.

I agree that the Eurosystem, composed of the ECB and the NCBs of the euro area, is not perceived a priori as a social body.

The ECB has to endure criticisms from the trades unions. The criticisms are heard from inside the euro area, but also from outside.
Concerning the convergence criteria for the access to the Euro area, the Unions regretted from the beginning the exclusive focus on economic convergence without taking into account of criteria for social convergence: level of employment, social protection... Repeatedly some new Member States suggest softening certain convergence criteria inherited from the Maastricht Treaty.
Indeed, the ECB may appear as very determined in the process of convergence imposed on the Member States with derogation, in particular for the new Member States.
It is a chance today to speak to trade union representatives.

For some time, relations between trades unions and central banks have been organized in some Member States; the law authorises trade union representatives to take part in discussions in supervisory or management Board of some central national banks, concerning the general economic situation.

At European level, one may regret that the law does not foresee some kind of dialogue between the central banks and the social partners.

Even internally, the ESCB is not subject by law, to a formal social dialogue with the staff representatives.
Of course the general principles laid down in the European Social Charter (Council of Europe’s instrument signed in Turin on 18 October 1961), the Community Charter of the Fundamental Social Rights of Workers (1989), the Charter of Fundamental Rights, mentioned in article 6 of the EU Reform Treaty, are to be respected; they protect in particular the workers right to information and consultation, and the exercise of collective rights at the intervention of the trade unions.

The Governing Council of the ECB took the initiative in 1999 to set up a framework for social dialogue, but it remains informal.

Workers' organizations' representatives are invited to take part in this dialogue but there are no social elections organized at the level of the Eurosystem or the ESCB.

The question of the representativeness of the trade unions inside the ESCB remains a delicate matter.

There is no harmonization, far from it, of the legal framework for social dialogue inside the various central banks.

This is also a problem for the young Central bank of Luxembourg (BCL). A regime inherited from the former Institut Monétaire Luxembourgeois is still in place to ensure staff representation but in a rather loose legal framework. Recently the Board of the BCL, took the initiative in proposing amendments to the statutory provisions in this area, in order to provide for a democratic and effective staff representation.

Some central banks, as in Belgium or in France, are ruled by the general labour legislation. At the Banque de France, elected representatives of the staff rank among the members of the General Council; they are invited to participate in the discussion on social matters.

Of course, staff representatives shall not influence the way an independent central bank is carrying out its duties. Trade unions are among the "bodies" which, like the governments, are not authorized to influence the members of the decision-making bodies of the ECB or the national central banks, in accordance with article 108 of the Treaty.

Trade unions of course are free to criticize; it is also their role.

If I'm among the accused, let me defend myself; Ladies and Gentleman, I will plead "not guilty".

If central banks are deemed to be an evil genius (mauvais génie), I will answer that they may be scapegoats (boucs émissaires).

My defense will contain three parts.

First, let me explain that central banks' objectives have a social dimension.

Second, I will try to demonstrate that the central banks' policies contain a social dimension.

Third, I wish to underline the social dimension of central banks' messages concerning structural policies to be adopted.

3 Social dimension of Eurosystem objectives

Surprisingly perhaps, it can be said that central banks' objectives are basically social.

Like the money itself central banks have a social justification.

This can be explained from the angle of the political economy, as well from the analysis of their legal functions.

3.1 Ideology and economic science

When I was young, economic discussions were dominated by political ideology, in particular by the old debate between the socialists and the liberals.

Presently, in Europe, the ideological debates have diminished.

Does that imply that liberalism has won? I would not be so radical.

If liberalism has made considerable progress, social protection remains effective in Europe.

Liberalization and globalization are developing in parallel with progress in public and private governance. Who will dispute today that globalization requires effective social protection and good governance?

The fact is that we are more pragmatic in economic policies today than in the past.

Does that mean that the conflict of ideologies has been won by the new ideology of pragmatism?

I would refrain from saying that.

The present pragmatism may be seen as the recognition that the conflicting ideologies, in the end, relied on shared common values.

We are not looking anymore for a third way between conflicting ideologies but are we not building a truly European economic and social model?

The new European constitutional chantier, with the Social Charter, demonstrates how concerned we remain about our common values.

Freed from ideological conflicts, the dialogue between central banks and social partners may be pursued in a serene way, on the basis of economic analysis.

The economic science was developed, so to say, outside ideological or philosophical debates.

The starting point of the Apostle of liberalism, Adam Smith, was the analysis of the functioning of the mysterious “market”. For the author of “The Wealth of Nations” (published in 1776), the development of competition leads to greater utilization of resources and the maximum satisfaction for all, consumers and producers, compatible with the resources at their disposal.

This result is obtained by starting out from individual self interest. Consumers rational choices induce producers to improve supply, reduce costs and waste, create new products and pay attention to their quality.

The mysterious chemistry, carried out by the famous “invisible hand”, allows the “homo oeconomicus”, pursuing its own interest and profit, to contribute to economic development and social welfare.

With the reign of the micro economy, and the focus on the business, coincided the recognition in constitutions and laws of individual freedom.

When economic science was still in its infancy in the XVIII and the XIX centuries, its individual approach was heavily criticised by the radical socialist theories, as well as by the ultra-nationalist visions. They both inspired revolutionary experiences of state-controlled economies.

On their part, the religions adopted a nuanced position among the protagonists who sometimes were united against them.

One could refer to the position of the churches opposing materialism but defending immaterial values and supporting compassion and charity as instruments of social life, pleading for common good and sound governance in the respect of basic values and principles.

Among the religions, Christianity may appear as complacent for bankers. The duty to « give to Cesar what belongs to Cesar and to God what belongs to God », was hardly seen as an objection to the issue of currency by a sovereign power. Usury is a fault but a loan with a reasonable interest is acceptable.

The views of the Protestants, with their insistence on personal achievement and consciousness, proved especially supportive for bankers.

The Catholic Church encourages a spirit of poverty but is not negative about finance. It considers interest rates as legitimate so long the profit corresponds to a reasonable compensation for the creditor deprived temporarily from the use of his money. Since the end of the XIX century, the social doctrine of the Catholic Church with Leo XIII’s encyclical Rerum Novarum, contributed to the pacification and active concertation inside and outside catholic circles.

The Islamic religion for its part is presently supporting the development of Islamic Banking.

After the industrialization engendered the social question, globalization and liberalization are now calling for adequate economic policies.

We are confronted with a strange situation in the EU. Former communist countries, disappointed by the socialist experience, appear tempted by radical free-market policies, while western countries, committed to a free economy, maintain very costly welfare States.

The invisible hand of the homo oeconomicus is not considered as the only rationale for a good functioning of the market.

Keynes with other macro-economists of the twentieth century abandoned the attempt to describe economic reality starting from the rational behaviour of individuals. Focusing directly on the large economic aggregates-income, saving, investment, money, employment, public expenditure- he created a new vision of how relations among aggregates behaved, all of them of major importance for the economic and social welfare of nations .

Central banks are now basically public services, acting in a non-competitive context. Their raison d'être is to provide a common good (good money) to contribute to good public governance, in a process of checks and balances with the governments and the market forces.

We need economic policies to ensure competition and the smooth functioning of the market but also to achieve a sound legal framework for economic operators and consumer protection or to protect the global environment.

For centuries, the money was more or less kept distinct from economic policies, gold was seen as a universal real currency, and it was affected by national denominations. It lasted until powerful governments, especially when driven by nationalistic or dogmatic vision, tried to influence or to directly regulate the external and internal value of the national currency. In Europe, with so many sovereign powers issuing currencies, the desire of international monetary cooperation is strong. When the Bretton Woods system of fixed parities imploded in 1971, the immediate reaction of the hard core of European countries was to seek to conclude, regionally, new monetary agreements.

Under the original Treaty of Rome, monetary policy was kept as a national competence to be exercised by the governments of the Member States. There was no need to organize a common regime for central banks. If central banks have been established in almost all independent States, their original task was to issue banknotes. Only recently, they became instrumental in the conduct of monetary and exchange rate policy,

A monetary policy conducted by an independent central bank is deemed to be a formidable experience for Europe today. It is anyway a cornerstone of the European construction.

The recent European experience is unique in the world.
We have still to prove that this new model is sustainable and provides a model of reference for other States or regional unions in the world.

3.2 Price stability as a social objective

In essence the European Union is combining economic and social objectives.

Following the draft Constitution, the Reform Treaty, presently discussed in the Intergovernmental Conference, shall reaffirm the values and objectives of the European Union; the monetary union is just a part of the European Union contributing to the same objectives.

This is mentioned clearly in the Reform Treaty. Following the Article 3 of this Treaty, devoted to “The Union’s objectives:

” The Union shall establish an economic and monetary union whose currency is the euro.”

The ECB has welcomed this new provision establishing EMU as an objective of the EU (see its Opinion published in July 2007). EMU contributes indeed to the achievement of the European Unions’ objectives containing an important social dimension.

Article 3, paragraph 3, reads as follows:

“The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress and a high level of protection and improvement of the quality of the environment.

It shall promote scientific and technological advance.

It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child.

It shall promote economic, social and territorial cohesion, and solidarity among Member States.

It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe’s cultural heritage is safeguarded and enhanced.”

Following repeated suggestions of the ECB, the Treaty will now provide that price stability is an objective for the European Union as such.

It was already, since the Maastricht Treaty, the primary objective of the Eurosystem.

One should refrain from the vision considering inflation to be a mere monetary problem to be tackled by the central bank while for its part, economic policy would be aimed at growth and employment. Such a dichotomous vision would not be in line with the new treaty provision. Price stability is an objective for all including the national governments; for monetary policy it is the primary objective.

A particular concern of a central banker is that the fight against inflation is hardly seen as a social objective. We have to make it clear that maintaining price stability is conducive to social cohesion.

It is not an easy task.

Except in some countries which remember the dramatic consequences of hyperinflation, some inflation is not always resented as bad.

It is a legacy of the long disputes between the “monetarists” and the “budgetarists” in economic science, that a trade-off is believed to exist between inflation and employment.

This is all the controversy around the so-called “Phillips-curve”.

This might be a negative legacy. Inflation does not, at least in medium term, favour employment.

On the contrary, central banks’ concerns about inflation are often in relation to over-generous wage deals conducive to lower employment.

Protection against inflation can be seen as part of social protection. Countries like Belgium or Luxembourg do provide for automatic indexation mechanisms; elsewhere social partners may agree on them. Mechanisms of wage indexation make inflation harmless in the short-term, but they need to be adapted in case of serious revival of inflation. In the medium term, nevertheless, there is no other solution than price stability. This is a more effective protection for wage-earners or recipients of social transfers than indexation mechanisms.

One possible benefit of inflation is that it may grease the workings of the labour market. As argued by Tobin (1972), if wages are rigid downwards in nominal terms, the existence of some inflation will reduce the risk that downward wage rigidity is binding. Hence some inflation will alleviate wage pressure. The need to protect living standards creates a downward rigidity of real wages. It means that social protection might support price stability while basically price stability contributes to social protection.

A common fear is that central banks consider the generally observed downward wage rigidity as an obstacle for wage dynamic.

The fact is that it is difficult to reduce nominal wages or salaries.

Downward rigidity concentrates on nominal wage, even if workers may resist real wage cuts as well as nominal wage cuts. We find, notwithstanding substantial variation across countries, a tendency for worker’s wage changes to clump in the vicinity of the expected rate of price inflation. This evidence of downward real wage rigidity is particularly robust in countries with greater union density.

We should keep in mind that like inflation, deflation is incompatible with the objective of maintaining price stability. Even if the general price level was to decline, it would be difficult to reduce nominal wages and salaries.

At the micro level, normally, pay cuts save few jobs, so that if the response to labor redundancy were to cut pay, there would still be too many employees for the amount of work. Pay cuts do occur in very specific circumstances, when a large number of jobs in sensitive sectors are at stake. This is exceptional; usually, pay cuts would not save many jobs. Pay cuts are negotiated in particular cases when the link between labour contribution and remuneration is not more evident.

4 Social dimension of Eurosystem policies

4.1 Monetary policy

Every day, we hear complaints about ECB policy.

Is the euro reducing prices or, on the contrary, increasing them, euro being “teuro”?

Aren't interest rates too high?

Is the exchange rate of the euro sustainable for the economy?

Let me answer by facts.

In the history of Europe, since the creation of the Common Market, never was inflation so low as today; the same is true for the interest rates at short and long term.

Concerning the exchange rate, the relatively recent appreciation of the euro has not harmed the moderate but rather continuous economic growth in the euro area.

For many years, the fluctuations of exchange rates were a nightmare for the integrating open economies while now most transactions are made in the new single currency.

Is anybody of the view that monetary policy should be entrusted back to national governments in the euro area?

The introduction of the single currency has positively induced more transparency, more stability and lower inflation.

The euro area witnessed a considerable improvement in the employment situation; unemployment rate in the euro area is now at the lowest level for many years.

The overall employment rate increased from 58 % in 1996 to 64, 4 % in 2006.

Since 1999, in the euro area an increase of more than 12 million of employed people has been witnessed.

We observe in the euro-area a simultaneous decline in inflation and in the labor share of income. One should not hastily conclude that both phenomena are connected, in the sense that the decline of the labor share is the result of the decrease of inflation.

The ECB reacts strongly to the criticisms of some governments concerning the exchange rate of the euro. There seems to be a serious misunderstanding in this area.

A “strong” euro, succeeding to a “weak” euro at the beginning of the monetary union has not proved to harm the economy. On the contrary, it may in many ways, be considered as an element fostering productivity and stable growth. It contributed anyway to dampen the recent increase in energy and commodity prices.

The confusion remains at the institutional level.

Some governments refer to article 111 of the Treaty referring to the competence of the Council (of Ministers) as political body empowered to act in the field of exchange rates. For its part, the ECB insists on the primary objective of price stability. It is not alone in the world today. Since the collapse of the Bretton Woods system, of binding exchange rates agreements, the role of independent central banks is increasing in the international field.

The links between the internal and the external value of the currency are duly taken into account in the monetary analysis. Following the Reform Treaty, the division between monetary and exchange policies shall be even less explicit. The concept of monetary policy in the new Treaty, as a Eurosystem exclusive competence, has a very large scope, it includes, in accordance with the ECB Opinion on this point, not disputed by the IGC various aspects, including payment systems or external relations. Of course the Governing Council of the ECB has to stick to its mandate imposed by the Treaty which is twofold.

«The primary objective of the Eurosystem shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Communities with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of this Treaty.»

Some consider that monetary policy is conducted by economic bureaucrats unaware of the social implications of their decisions. They should be aware that monetary policies are not conducted anymore by politicians who might be more concerned by the forthcoming elections than by economic rationales.

Any decision of the Governing Council is taken after extensive analysis of the monetary conditions (the so-called first pillar with the monetary aggregates), but also of the economic and social situation in the euro area and in the world.

It is very much aware of the fact that the presently 13 (soon 15) euro area Member States are not forming an island but represent a very open economy.

4.2 Financial Stability

The Eurosystem has also, in virtue of the Treaty, the mandate to contribute to financial stability.

It is a very challenging task for central banks, especially in present circumstances with financial turmoil.

It can be said that financial stability is per se a social objective.

We know the dramatic consequences of economic and financial crisis for the economies and the people.

The Eurosystem has proved that it is capable of preventing or, if necessary, managing financial crisis.

In this area, a lot of work has still to be done notably in the institutional field. It is important for a central bank to be effectively equipped to prevent or to act.

The institutional arrangements in Europe in this area are to be enhanced and reviewed; this is an important matter presently under discussion.

4.3 Policy mix-Public finance

The Eurosystem has also the task to support fiscal policies and economic coordination; this is a particularly complex function in an enlarging European Union.

The Eurosystem with its exclusive competence in monetary matters is confronted with a multiplicity of economic policies developed by governments as long as economic competence in the Union is shared between Member States.

The basic asymmetry remains with a centralised monetary union and a decentralised economic union.

The role of the ECB cannot be compared with the role of central banks in national economies.

We have to live with significant differences of policies and economic results across the European countries.

In accordance with their role of supporting the economic policies, the central banks encourage fiscal strategies focusing on strengthening consolidation efforts.

You know how much the ECB is concerned by public deficits and by the respect of the Stability and growth Pact. It is of critical importance for monetary policy, especially so long there is no European economic government responsible for crisis management.

There is no alternative to strict fiscal discipline.

Fiscal developments in the EU, especially in the euro area, are remarkable. The discipline imposed by the Treaty of avoiding excessive public deficit, has been implemented through the convergence programs for the non euro area members and through the stability programs for the euro area countries, in the framework of the Stability and Growth Pact.

The ECB insists on the need to respect fiscal discipline and to enforce effectively the SGP, aiming at a policy of balanced budgets in the medium term. Sound fiscal policies are fundamental to the success of economic and monetary union. They are prerequisites for macroeconomic stability, growth and cohesion in the euro area.

In an environment of strengthening economic activity, the aggregate general government deficit ratio for the euro area stands at less than 2% of GDP, below the reference value of 3 % of GDP. However, much remains to be done in order to converge quickly to balanced budgetary solutions.

The euro area public debt ratio approach the reference value of 60 %, being slightly below 70 % of GDP in 2006; however, this debt ratio was already below 70 % in 2004.

In the present context of uncertainty, should I mention the preoccupations concerning the French budget?

The ECB has the difficult task of cooperating with the governments; it benefits from the existence of the Eurogroup, as informal but effective centre of economic coordination for governments of the euro area.

The ECB was deeply concerned by the revision of the SGP in 2005.

Flexibility of the revised framework should not induce relaxation of its rules. The revised framework needs to be implemented in a rigorous and consistent manner, which is conducive to prudent fiscal policies.

We need also, in this area, further structural measures.

The criteria of the Treaty concern public deficits and debts, only.

Nevertheless, a smooth functioning of the internal market supposes also an efficient but limited public sector.

It may be noted that public spending in the EU increased from about 30% of GDP on average in the 1960s to nearly 50% in the 1990s.

There is evidence that this may come at the cost of lower growth.

Public spending limited to 30-35% of GDP has proven to be sufficient if money was well spent.

New methodology was developed by the Eurosystem to measure and compare internationally the performance and efficiency of government on core objectives (infrastructure, health, education, administration, income distribution...)

ECB work has shown that there are limited or even non existent economic and social costs of downsizing government via public expenditure if reforms are appropriately designed and implemented. In addition, downsizing government expenditure would make it easier to enhance the resilience of social security – in particular the pension system- to macro-economic or other shocks.

5 Social messages of the Eurosystem

EMU in some ways increases the risks of weakening the process of structural reforms. In the past, devaluation was a tool to improve domestic social measures. Fear of devaluation, was an incentive for competitiveness and social cohesion.

Monetary union by itself does not guarantee a smooth functioning of the labour market.

The Eurosystem has carried out extensive analyses of the social sector.

Each monthly communication on the monetary policy by the ECB President includes an invitation for more structural reforms, especially in the social area.

Let me limit myself to 3 topics:

- a better functioning of the labour market, with increased labour productivity and mobility,
- the consequences of the ageing population
- the investment in human capital.

5.1 Labour productivity and mobility

Over the past ten years, the development of euro area productivity has been disappointing. Average annual labour productivity growth declined in Europe (from 2,1 % in the period 1990-1995 to 1.3 % in the period 1996-2005, while it increased from 1.1% to 2.4 % in US over the same period).

Basically, the overall employment rate in the euro area is below that recorded in the US.

The female employment rate was 56, 5 % in the euro area and 66 % in the US.

The youth employment rate was 37 % in the euro area and 54,2% in the US.

It means that in Europe some groups remain at the margin of the labour market, prevented from entering in it.

The need to raise employment levels in the euro area will to some extent put pressure on euro area labour productivity growth ; in this context, measures aiming at reduction of taxes, limitation on early retirement, as well a relaxation of employment protection legislation or support for the development of part-time work are preconditions

All in all, despite significant progress in some areas, structural reforms in the EU have not been far-reaching enough, and their implementation has been too slow to foster the emergence of a “knowledge-based economy” aimed at boosting labour productivity growth and enhancing job creation.

When advocating structural measures in view of a better functioning of the labour market, the Eurosystem is suspected of neglecting social protection.

We should refrain from any Machiavellian vision.

Changes in the labour market are needed; a larger and better functioning labour market will contribute to global employment but it entails more mobility and flexibility.

The approach is similar to the other segments of the market; there are some similarities between the financial and the social sector, both subject to considerable regulation. Flexibility and competitiveness call for more mobility and removal of obstacles.

Our social markets are still very fragmented.

Unemployment as employment policy has today a European dimension.

Not only are unemployed seeking for a job; but employed workers also search for jobs, so that vacancies can be filled with employees of other, less productive, firms that pay lower wages.

Maybe since all workers compete more strongly for the available vacancies, the wages of incumbent and newly hired workers rise less than in the standard vision, with the cyclical dynamics of vacancies and unemployment.

This is the context of the wage moderation advocated by the Eurosystem.

Wage moderation implies a sufficient level of wage differentiation; it is not to be seen as a pressure "à la baisse" of all salaries; it is aimed at functional relations between labour, production and salary.

It may be a paradox for central banks which aim at price stability to insist on more flexibility in social matters.

The paradox is only apparent.

Wage flexibility is only opposed to automatic global increases. It has to be seen as the possibility for those working more efficiently to be better paid.

Labour market flexibility is not to be understood as a lowering of employment protection (cf.: the polemic in France about the "Contrat de 1ère embauche")

Stricter employment protection reduces the incentive for job creation but it produces fewer dismissals too.

In the economic literature, a clear link between employment protection and unemployment has not yet been established.

Mobility has increased, but only very slowly. Mobility could help dramatically but the net migration in the EU remains very low (around 2 %), lower than in the US (around 4 %).

We observe the arrival of Polish or Baltic workers in particular in the British Isles, but no other substantial increase of mobility is expected for the moment at EU level.

At the best, we hope a stabilisation after a possible fall until 2010.

Considerable obstacles should be removed to promote the mobility of the workers and the people. We can mention the cultural or linguistic obstacles, the limited transferability of social security benefits, the various tax regimes, the unequal access to education or other public services.

5.2 Ageing population

For the euro area, the projections imply that after 2020 the population will start to shrink in absolute terms and that by 2050 every third person will be older than 64. The impact of ageing population could reduce growth in Europe by nearly half by 2040.

The first challenge is getting more people into work, residents and immigrants. In some countries, the priority is to raise retirement age. An innovative environment should allow efficient people to continue to work. This does not represent a reduction of legal protection.

As incentives to work, we need tax and benefits systems, flexible working hours, part-time and temporary facilities.

The prospective demographic trend implies a severe burden in terms of pension schemes and health care systems.

Central banks have good reasons to be critical about early retirement schemes or obligatory limitations of working hours.

5.3 Investment in human capital

Europe is lagging behind US and Asia in the field of education.

In particular the higher education is still clearly inadequate for a knowledge-intensive economy.

In the US annual expenditure on high education represented almost 3 % of GDP while in the euro area it represents only 1, 2 %. The gap is mainly a result of greater private financing in the US. We are simply too dependent on public financing, at national, regional or local level.

The remarkable achievements in the field of mobility of students (cf.: Erasmus program's) demonstrate that the linguistic and cultural obstacles may be removed, but there is still a long way to go. Many of our educational systems promote equal access. Nevertheless at the level of higher education can we be equal and excellent too? Probably not.

We should avoid opposing the basic objective of excellence with the constraint of equal access. We don't need all Europeans to be distinguished graduates but we need our graduates to be really competent.

European law promotes equality conceived as non-discrimination. This is probably the most important aspect of this basic social right: non discrimination between men and women, between different nationalities or cultures, between old and young people.

The European social market remains dramatically fragmented and discretionary.

6 Social analyses of BCL

Luxembourg represents a marvelous laboratory for social integration in Europe.

BCL has performed extensive work in the field of social analyses and research.

Indeed, the Luxembourg labour market is unique in Europe.

Employment exceeds now 335 000 people (July 2007); this rapid growth was fueled by non-residents.

Despite this strong employment growth, the unemployment rate is rising even if it remains globally moderate, reaching 4,5% on average in 2006 after 4,2 % in 2005.

Nevertheless, the central bank strongly opposes any protectionist measure in this field.

The vision of crowding-out residents by commuters is not realistic.

Let me quote the message of the Governor of the BCL in the latest annual report of the Bank:

“About two thirds of newly created jobs were taken up by non-residents. However, this inflow of cross-border commuters should not be seen as harming employment opportunities for residents. In any case, it would be difficult to reduce unemployment by creating more public sector jobs as these would be mainly filled by residents previously employed in the private sector, and the jobs vacated would be occupied by new cross-border commuters rather by unemployed residents. Finally, job creation in the private sector can be hampered by excessively rigid employment protection legislation, underlining the need to improve labour market flexibility. Fifty years after the Treaty of Rome and five years after the introduction of euro banknotes and coins, one cannot overemphasise the need to facilitate free movement of persons and thereby further open the Luxembourg labour market to take advantage of EU enlargement. “

Notwithstanding the remarkable growth of the economy and the employment, the central bank underlines the deterioration in competitiveness and the need to increase productivity considering the evolution of prices and costs of our trading partners. It strongly encourages the authorities and social partners to rapidly implement the structural reforms envisaged by the Lisbon Strategy.

The employment rate is still to be increased; it now reaches 63, 6% while EU employment rate has increased to 66 %.

The Luxembourg central bank underlined in various studies the sustainability gap of the public finance and in particular of the pension systems. It advocates proactive reforms in this field to avoid future shocks. A long term vision is necessary, also in order to preserve the purchasing power of future generations, which are of course not represented in the present political decision-making process.

Concerning the Real estate market, the price increases are neither in line with growth of disposable income of households nor with the increase in rents. With short supply and strong demand, the imbalance is compensated for by the cross-border markets. This creates a specific institutional problem, unresolved so far: inconsistency between the political organization, on the one hand, and the economic and social organization, on the other.

The ratio of research and development (R&D) in Luxembourg is below the 3% of GDP as set by the European Council. Improvements in the field of education, especially higher education need to be made following OECD studies.

Concerning labour protection, the central bank is pleading for legislative reforms but not revolutionary.

If the central bank underlines the need to improve the functioning of the labour market, it considers that “reform must be agreed with the social partners. In fact, several studies have shown that a good relationship between social partners is important for employment.”

7 Conclusions

As accused, I felt myself obliged to defend the central banks.
I may have failed.

The fact is that the relationship between central banks and trade unions is, unfortunately, rather loose.

Are central banks and trade unions enemies? I hope not.

Are they friendly adversaries? I'm not sure.

Central banks and unions are both actors in the economic and monetary union which has definitely a social dimension.

The need is to set up a partnership. There is a wide scope for a fruitful dialogue at various levels: European, national as well as inside our own institutions.

Basically, one should not any more place economic and social visions in mutual opposition. They are interrelated.

The schematic view according which the global economy is run by and for the rich (capitalists and bankers) against the poor (workers) is not relevant. Our globalised economies need good governance.

In this context, central banks have a role to play but in a process of checks and balances with other powers.

Europe has invented a new independent central bank, the Eurosystem, which has proved, after 10 years, not so bad from a social point of view, notwithstanding the recurrent criticisms.

Both, the central banks and the trade unions, are in the end working for general interest. They may walk together in the difficult way ahead.

We all share the same social values.

The monetary union is only one step in the long process started more than half a century ago and having as its objective an ever closer union for the benefit of all.

There is still a long way to go to build the European Union.

I thank you very much.

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