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Opening Address

Dear Governor,
Ladies and Gentlemen,
It is my pleasure to welcome you to Vienna, also on behalf of Federal Chancellor Faymann, who sends his greetings. I think the topic of this year's conference is timely and highly relevant for economic policy – as always with OeNB conferences.

In my opening remarks I would like to address three issues: first, I want to explore why economic growth is essential for our societies and why providing an appropriate framework for growth is a priority of our economic policy. Second, I want to specify in a bit more detail which growth model I am referring to; the EU's *Europe 2020 strategy*[1] delivers useful guidance in this respect. And finally, I will briefly lay out how we as policy makers can contribute to these long-term perspectives for economic growth.

Let me start by explaining why I consider economic growth to be so important for our society. In economics, there is quite a broad consensus from Karl Marx to Milton Friedman – I assume that range covers everybody in the room – a consensus that capitalist economies depend on economic growth to provide full employment.

Economically speaking, unemployment is a waste of resources and therefore should be avoided. But politically and socially it is much more than that: People out of work have diminished chances to participate in our society. They face a higher risk of sickness. And very often, they lose their self-confidence. The negative impact of unemployment on the personal lives of those affected is well documented and it is an important motivation for politicians to prevent unemployment and to reduce it whenever it occurs.

Low or even negative growth rates that cause unemployment also have a negative impact on the political stability of a country: contrary to widespread belief, it is not the unemployed who tend to vote for radical or extremist parties. The unemployed tend to stop voting at all. Very often, they do not feel represented any longer by political parties. But people still in employment who fear that they might share the dismal fate of the unemployed in the near future have a tendency to seek shelter with irrational fringe parties. They lose their confidence that conventional policies can provide economic growth effectively.

Even in countries that have weathered the crisis relatively well like Austria, we see a surge in political parties that do not offer a reliable policy alternative, but mostly appeal to instincts. Only if our policies provide long-term perspectives for economic growth – perspectives in which our citizens can believe – they will regain their confidence. And confidence is important for growth, but also for the stability of the political system.

But what do we mean when we speak about economic growth? Usually

[1] *For further information, see http://ec.europa.eu/europe2020/index_en.htm.*

we refer to the growth rate of GDP when in fact we want to increase the economic well-being of our citizens.[2] But there are varieties of growth models. For example, over a certain period, the Irish grew their economy quite successfully by buying from each other houses at higher and higher prices with

money they had borrowed from Germany and France; but this was not sustainable. This is not what we want.

What we want is smart, sustainable and inclusive growth as it has been defined by the EU's *Europe 2020 strategy*:

- What we want is a more efficient use of our natural resources.
- What we want is growth based on knowledge and innovation.
- What we want is a full-employment economy delivering social cohesion.

These are the priorities of the *Europe 2020 strategy* and I think they are well chosen. They provide a long term perspective for economic growth and the EU also has the tools and instruments in place to implement this perspective. I will speak about this more in a minute, but first let me tell you why I think these priorities form one integral strategy.

I think in a democratic society, inclusiveness is a pre-condition for sustainable growth.[3] Unbalanced growth that increases only the incomes of a happy few and excludes a big share of the population cannot go on forever: those who are excluded will become more and more frustrated and probably vote for the irrational fringe parties that I mentioned earlier.

These parties do not necessarily engage in redistributive policies, but they most likely run economic policies that are unsustainable in one way or another. For example, they might inflate the balance sheet of a state-owned bank to fund their populist extravaganzas and sink their country in debt. This is not what we want.

In history, as well as in some countries still today, we can find economic elites who exclude the majority of their fellow citizens from political participation. Not only is this incompatible with the democratic foundation of the EU, it is also bad economic policy: in a rigid system that excludes a part of its citizens, these citizens have no incentive to engage in more productive activities.

On the other hand, it is obvious that we should not use up much more of our limited natural resources. But we do have a resource which we have not driven to its limit yet and that is the innovative capacity of our knowledge based economy. In this respect it is quite surprising that some countries (Austria is unfortunately among them) still think they can afford policies that exclude a share of their youth from ac-

[2] *The Commission on the Measurement of Economic Performance and Social Progress, co-chaired by Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi published a seminal report in 2009 on alternative ways to measure economic and social progress.*

[3] *The importance of inclusive institutions that generate positive feedback loops for welfare and development has been highlighted in an impressive way by Daron Acemoglu and James Robinson in "Why Nations Fail" (2012).*

cess to better education. In our school system, the educational degrees of young people are more determined by their parents' degrees than in most other countries. This is not smart. This is not inclusive. This is not what we want. What we want and what we need is a more comprehensive approach to schooling that allows all the young minds to develop their maximum abilities, thereby increasing the innovative capacity of our economy. The Chancellor has been pushing for a reform of the educational system in Austria and I hope that we will succeed in making our schools more inclusive.

We know from economic research that early childhood education has very high returns especially for children with less educated family backgrounds.[4] If we invest in early childhood education now we will have a more inclusive society tomorrow and an economy with more people employed in better jobs. That is what we want.

So, now that we know what we want, how do we get there? We have a strategy that sets priorities for the whole EU, and we have the European Commission who translates these priorities into national targets. We have the European Semester which is kicked off each year by the European Commission's Annual Growth Survey. In the Annual Growth Survey for 2015,[5] the Commission focused on three pillars, namely investment, structural reforms and fiscal responsibility. These are all very important areas and they definitely contribute to boosting growth in Europe.

However, I miss the focus on inclusiveness. The process was streamlined and the European Commission focuses on a few priorities, I understand. But we have just gone through the most severe economic crisis in recent history, unemployment and social hardship has reached levels in some countries that have been unknown for generations – and not one single reference to social inclusion?

There is one reference in the Annual Growth Survey that says that *welfare systems should play their role to combat poverty and foster social inclusion* (p. 15). But at the same time EU Member States are kindly asked to decrease their deficits and debts and it goes without saying that those at risk of poverty do not have a strong lobby when it comes to defending their benefits; especially not, if the cuts in social policies are justified by fiscal responsibility.

Now let me explore in more detail, how I understand fiscal responsibility and how it could help to improve the long term perspectives for economic growth. A more active fiscal policy could increase demand in a time when the private sector in most countries is trying to reduce its debt overhang. I see that in the afternoon you will have a session on this topic, which I consider to be of great importance. Now if everybody wants to reduce his or her debt at the same time, we know well that the paradox of thrift can occur and while savings go up, income goes down and in the end the debt-to-income ratio may be stable or even increase. This is not what we want.

Here we are faced with a coordination problem as the individual actions of households and firms are rational in themselves, but the collective outcome

[4] *On the positive effects of quality early childhood interventions targeted toward disadvantaged children, see Heckman, James; Pinto, Rodrigo and Peter Savelyev (2013) "Understanding the Mechanisms through Which an Influential Early Childhood Program Boosted Adult Outcomes," American Economic Review 103(6): 2052–2086.*

[5] *See http://ec.europa.eu/europe2020/pdf/2015/ags2015_en.pdf.*

is negative. In this case, the public sector can break a vicious cycle by using fiscal policy and restart growth again. It is interesting to note, that in the recent past the European Commission and the ECB have asked Member States with fiscal room for manoeuvre to invest more.[6] I could not agree more.

But unfortunately, those with fiscal room for manoeuvre are obsessed with reducing debt levels while paying negative interest rates on their debt. All they seem to have learned from the crisis is that unsustainable debts will cripple the economy.

The critical issue here is that nobody can say exactly which debt levels

are unsustainable. As we commemorate the 200th anniversary of the Congress of Vienna this year, just let me remind you that back then England had a public debt of 250% of GDP and it took about 30 years to halve that. Nevertheless, the high debt level did not prevent England from reaping the benefits of the industrial revolution.

So it seems we are faced with a coordination problem not only within the private sector, but also among governments. We often speak about policy coordination at the EU level, but basically it never means to account for the spillovers from policies in different countries; mostly it boils down to monitoring that each Member State individually follows the rules. This is not the ordinary understanding of the word coordination. As ECB President Draghi has noted last year in Jackson Hole: "Stronger coordination among the different national fiscal stances should in principle allow us to achieve a more growth-friendly overall fiscal stance for the euro area."[7]

Now some might ask, is a fiscal stimulus not only a short term thing and does it effect long term growth at all? I just want to caution against this separation of short term from long term effects, because we know that short term unemployment has a tendency to become persistent if the short term lasts a little longer.[8] As so often, it is better to be safe than sorry.

We have implemented a fiscal stimulus in Austria with our tax reform which is on the agenda of tomorrow's ministerial council. This reform is the biggest tax reform ever enacted in Austria; it will increase disposable income for almost all citizens: more than 6 million people subject to income tax will benefit from this reform. Our tax reform will provide a much needed boost to demand. Median wages have been stagnating for years, and private consumption has been weak.

[6] *The European Commission has been explicitly demanding in its Annual Growth Survey that Member States with fiscal room for manoeuvre need to invest more.*

[7] *www.ecb.europa.eu/press/key/date/2014/html/sp140822.en.html.*

[8] *This insight is not particularly new, as can be seen by Blanchard and Summers (1986): "Hysteresis and the European Unemployment Problem," NBER Macroeconomics Annual.*

Obviously, we cannot implement a tax reform every other year to strengthen net wages. What we need for the long term is strong growth of wages hand in hand with strong increases in productivity. And for broad based productivity growth we need an inclusive educational system that allows us to strengthen our innovative capacity.

As I am starting repeating myself, let me stop here and thank the Oesterreichische Nationalbank for hosting this conference. I think in bringing together international academics, policy makers, bankers and central bankers here in Vienna, you provide us with a good opportunity to listen to and learn from each other and so hopefully increase our productive capacity.

I wish you all two days of inspiring presentations and lively debates and maybe also some time to enjoy this lovely city of ours.