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The 2004 Ludwig Erhard Lecture

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Determinants of Growth and the Role of Structural Reforms and Macroeconomic Policies in Europe

I. Introduction

This is the First "Ludwig Erhard Lecture" of the Lisbon Council's Board of Economists, and I am delighted to have the opportunity to address such a distinguished audience. Being invited to a première is always a privilege and a great pleasure. Opening a lecture series named after Ludwig Erhard is more than that: it is an inspiration and a challenge at the same time. I find it very fitting that the organisers chose to dedicate this series to Ludwig Erhard, for his ideas and convictions are very much related to the core objectives of the Lisbon Council. The people of Germany refer to Ludwig Erhard as the father of the post-war economic "miracle", since it was his policies as economics minister and Federal Chancellor in the period 1949-1966 that laid the foundations for the remarkable recovery of the country's war-torn economy. In Europe at this juncture, it might not be realistic to expect a "miracle", but we certainly need a "remarkable recovery" of its growth performance. And we need economic policies that will "make Europe fit for the future", as the motto of the Lisbon Council declares.

"Prosperity for all" ("*Wohlstand für alle*") was the core objective of Erhard's economic policy. The central concept of his policy – the Social Market Economy – sought to reconcile, on the basis of free competition and a solid macroeconomic framework, notably stable prices, the ideal of personal freedom with growing prosperity, social security and a policy of openness towards the world.

> *"Die Politik der Sozialen Marktwirtschaft stand seit dem Tage der Währungsreform unter der Leitidee, auf dem Boden einer freien Wettbewerbswirtschaft persönliche Freiheit, wachsenden Wohlstand und soziale Sicherheit in Einklang zu bringen und durch eine Politik weltweiter Offenheit die Völker zu versöhnen." (Speech at the 9th CDU Party Conference, Karlsruhe, 28 April 1960.)*

Today, more than 40 years on, Erhard's ideas have lost nothing of their validity. The central planks of the Lisbon Strategy – aiming to raise Europe's growth potential and competitiveness in order to shore up what is referred to as the European Social Model – are very similar to Erhard's conviction: a clear emphasis on giving sufficient room for the beneficial effects of competition, individual choice and entrepreneurial spirit and the confidence that the resulting growth will generate prosperity for all and provide the means for an adequate social safety net.

Against this background, the assessment of the implementation of the Lisbon strategy is mixed at best. The European Union and its Member States have been implementing the Lisbon strategy for four years now. In that period, undeniable progress has been made in certain areas and in some countries. Nevertheless, economic growth in the Union has remained disappointing. The gap in real GDP growth *vis-à-vis* the United States – the obvious comparison and reference point – has even widened. Overall, the progress made in most Member States with regard to delivering the Lisbon strategy has been clearly insufficient. If Europe is to achieve its targets of higher growth and increased employment, it definitely needs to step up its efforts.

In addition to making Europe more competitive and dynamic, the implementation of the reforms on the Lisbon agenda, by improving productivity growth and easing labour and product market rigidities, will also enhance the effectiveness of monetary policy to preserve price stability under monetary and financial conditions fostering faster and sustainable growth.

In order to assess the means and policy challenges for promoting growth in Europe, I will first review the past growth performance of the euro area, in particular in comparison with that of the US, and I will identify a number of key structural factors which explain its lagging output growth. Then I will elaborate on the kind of reforms which I see as essential in "making Europe fit for the future".

II. Assessing the euro area's growth performance relative to the US: key features and determinants

Let me start the assessment of the euro area's growth performance by recalling a few facts. Average real GDP growth in the euro area declined between the 1980s and 1990s, and the gap in real GDP growth between the US and the euro area widened (see slide 1 showing the gap in real GDP growth between the United States and the euro area: 1980-2003).

During the 1980s, euro area aggregate output rose on average by about half of a percentage point less than the US rate of growth. In the 1990s this gap (almost) doubled and it has widened significantly since the mid-1990s. In particular, from 1995 to 2000, the average gap was close to one and a half percentage point (see slide 2 on the gap in real GDP growth since the mid-1990s.) During this period, the US experienced a boom driven mainly by advances in information and communications technologies (ICTs), while the euro area economy expanded at a relatively robust but average rate. Subsequently, the downturn in 2001 affected both economies. In the US, however, although economic activity initially decelerated more rapidly, it then recovered much faster and it is expected that it will grow by more than 4% in 2004, a rate about twice as high as the Commission's forecast for real GDP growth in the euro area. Indeed, (as shown in the chart on slide 2) since the adoption of the Lisbon strategy in 2000, average real GDP growth in the euro area has been only around 1% per year, which is about half of that in the US.

When assessing the European economy's performance, it is worth pointing out that the living standards in the euro area, as measured in terms of real GDP per capita, developed relatively more favourably. There is nevertheless still a gap between the per capita real GDP growth in the US and the euro area, which however is less marked (about 0.6 of a percentage point on average in the period 1996-2003) as a result of more dynamic demographic developments in the US (see slide 3 depicting per capita real GDP growth in the euro area and the US).

What have been the main determinants of the average output growth in the euro area and its relative deterioration vis-à-vis the US since the mid-1990s? And how do these determinants relate to some of the objectives and envisaged policies of the Lisbon strategy? Using a growth accounting framework, we can explain the gap in GDP growth between the US and the euro area in terms of differences in the rates of change in productivity, labour utilisation and population (see slide 4 showing the decomposition of real GDP growth in the euro area and the US, 1996-2003). Labour utilisation, which I will define precisely in a few minutes, can in turn be decomposed into a number of other variables (such as the labour force participation rate, the unemployment rate, and average hours worked per employed person) which can be influenced by policies.

The contributions to real GDP growth in the euro area and the US of the (rates of change in) productivity, labour utilisation and population in the period 1996-2003 are shown in slide 4. The analysis shows that, since the mid-1990s, euro area real GDP growth has been mainly driven by labour productivity growth as measured by the rate of change in real GDP per hour worked. In the US, however, average productivity growth was significantly higher, by a full percentage point – an impressive performance considering that this period included a slowdown in activity. Population growth also contributed substantially to US growth. The degree of labour utilisation improved in the euro area and had a positive impact on its growth, while it declined in the US resulting in a modest negative contribution. I will now discuss in somewhat more detail the relative importance of these determinants of long-term growth and the underlying factors that have influenced their development.

Labour productivity growth is typically the most important determinant of long-term potential output growth. And this has been the case for both the euro area and the US since the mid-1990s. Productivity growth in the euro area, however, has declined since the early 1980s. In the more recent period 1996-2003, it continued to decline and for the first time fell behind that in the United States (see slide 5 on the turnaround in labour productivity performance between the euro and the US since the mid-1990s).

The continued decline in euro area productivity growth is observed independently of the measure of labour input used. In Europe, however, growth has generally been higher when measured by per hour worked rather than by per person employed, as shown in the two charts of slide 5. Although productivity comparisons across countries are often fraught with statistical or methodological problems, the findings regarding the evolution of productivity growth in the euro area and the US are largely independent of the concepts used. In the period from 1996 to 2003, around two thirds of the gap in real GDP growth between the US and the euro area can be attributed to differences in the growth of labour productivity (measured by real GDP per hour worked).

The main reasons for this turnaround of the labour productivity growth performance between the euro area and the US since the mid-1990s are twofold: On the one hand, the production and diffusion of Information and Communication Technologies (ICT) in the United States; on the other hand, wage moderation and labour market reforms, targeting young and unskilled workers and lowering their labour costs so as to increase the “employment intensity” of growth in the euro area. The reduction in labour cost has induced firms to shift to more labour intensive production, reversing earlier substitution policies in favour of capital, which resulted in a slowdown in labour productivity growth.

A second determinant of economic growth, which can play an important role in fostering growth in Europe and attaining the objectives of the Lisbon agenda, is labour utilisation. This can be defined as hours worked per head of total population. Labour utilisation can be expressed in terms of four components:

(1) hours worked per person employed,

(2) the share of employment in the labour force (which is related to the unemployment rate),

(3) the labour force participation rate (that is, the labour force as a share of the working age population), and

(4) the share of the working age population in the total population.

The table on slide 6 shows the decomposition of the rate change of labour utilisation into the rates of change of these four variables (see slide 6 on the decomposition of labour utilisation in the euro area and the US). The decomposition is interesting and helpful for two reasons: first, in order to better understand the underlying factors affecting labour utilisation, and second, because these factors can be influenced by policies in a way that can contribute to improving the economy's growth performance.

Since the mid-1990s, growth in labour utilisation in the euro area and its relative improvement *vis-à-vis* the US (where labour utilisation declined) contributed positively to euro area growth and in narrowing the growth gap with the US. What is important to emphasise, however, is that despite the improvement over time, and relative to the US, the level (as opposed to the rate of change) of labour utilisation in the euro area is much lower than in the US. This reflects a lower labour force participation rate, a higher unemployment rate, and lower average working hours per person employed in the euro area.

The figures in the table on slide 6 show how labour utilisation, and thus growth, in the euro area have been supported by an increase in the working age population that is employed (as manifested by a significant increase in labour force participation and a moderate decline in the unemployment rate) but it has been reduced by a decline in average hours worked per person employed. Despite, however, the relative improvement in the unemployment and participation rates in the euro area, the unemployment rate is currently still 3 percentage points higher, and the labour force participation rate around 8 percentage points lower, in the euro area than in the US (see slide 7 on the determinants of labour utilisation). The latter difference reflects in particular lower participation rates of women and older persons. The improvement in labour utilisation partly reflects the favourable effects of past labour market reforms. When looking at the levels, however, of unemployment and labour force participation rates, at which these improvement took place (as shown in the two charts on slide 7), it is clear that there is no reason for complacency and there is plenty of room for further improvements on both of these labour market fronts in the euro area.

I conclude this review and assessment of key determinants of the growth performance in Europe with two final observations. Euro area growth has been adversely affected, not only since the mid-1990s, but since the early 1980s by a continued decline in average hours worked per person employed. At present, annual hours worked per employed person in the euro area are about 300 hours lower than in the US and also lower, by around the same amount, than they were in the euro area in the early 1980s (see slide 8 depicting the average hours worked in the euro area and the US). The widening of the gap between the US and the euro area reflects the shortening of statutory full-time working weeks and the rising share of part-time employment. In the United States these latter determinants have remained broadly stable.

Finally, let me refer to the ultimate determinant of long-term economic expansion: population growth. In the US, this has been on average about four times higher than in the euro area since the mid-1990s. The gap has been even larger with regard to growth in the working age population, reflecting the fact that Europe has a more acute problem of population ageing (see slide 9 presenting old age dependency ratios).

III. From diagnosis to policy remedies

All in all, this not a particularly flattering diagnosis of some of the underlying causes of Europe's growth performance. Of course, I focused on a specific set of supply-side determinants of economic growth. Economic growth is also influenced by other factors, including the macroeconomic policy framework and stance. I will deal with some of these aspects, including the contribution of monetary policy to growth, later on in my presentation.

The diagnosis I presented would have been a rather futile effort if it did not point the way to the necessary policy action to remedy existing deficiencies: to develop growth-oriented economic strategies aiming at stimulating both labour utilisation and labour productivity, within a framework of sound and stability-oriented macroeconomic policies. It is clear that this is easier said than done, especially in the current environment, where the European economy is facing two additional challenges related to, first, population ageing and, second, the potential effects of the recent EU enlargement.

With regard to the first challenge, the old age dependency ratio in Europe, defined as the population aged over 64 years relative to the working age population, is projected to increase from about 25% in 2005 to just over 30% in 2020 and more than 50% in 2050. This population profile will not only put pressures on the sustainability of welfare systems, but also negatively influence potential output growth – unless remedial actions are taken.

Second, even though the recent enlargement is overall expected to produce significant economic benefits, for both the "older" and the new members, it cannot be denied that it may trigger structural adjustments which have raised certain concerns among the public. Sometimes these take the form of diffuse fears, for instance, about labour mobility and migration, industrial relocation, outsourcing and tax competition. Nonetheless, they have to be taken seriously. A more dynamic European economy should definitively help to dissipate these concerns. At the same time, the competitive pressure from the new Member States might turn out to be a "blessing in disguise" since it could spur on the much-needed structural reforms in the "older" Member States.

IV. Policies to promote long-term growth

Bearing in mind these two additional challenges, what should be done? What is the role of policy in promoting long-term growth in Europe? While it is clear that public policy should not directly interfere with market mechanisms in trying to stimulate economic growth, it is undisputed that setting an appropriate framework for markets to function efficiently is crucial. It is for public policy-makers to implement the necessary structural reforms that are key to making the EU economies more competitive and dynamic.

That said, implementing structural reforms has been – and continues to be – a very demanding task in many European countries. Apart from a lack of information on the side of the public about the necessity and beneficial effects of reforms, resistance may arise because the costs and benefits of individual reform measures as well as the time-horizon over which they occur are uncertain. While economic, social and political costs might already arise in the short-run, benefits often only materialise in the longer run.

Policy-makers face a dilemma that is best described in terms of Schumpeterian "creative destruction". Even though innovation and technological change open up prospects for higher productivity, higher wages and improved living standards, such supply-side shocks will transform job characteristics, displacing workers, making some skills obsolete and possibly increasing temporarily the unemployment of particularly low-skilled workers. The costs, in terms of unemployment, associated with such changes are likely to be concentrated in the short run, while the benefits in terms of higher productivity and improved living standards may take a longer time to materialise.

Addressing this dilemma is a constant challenge in the process of implementing structural reforms. Pro-active communication about the reasons and need for reform is crucial in this context, as is an honest presentation of the expected benefits and of the inevitable transitory costs. A tool, which so far has not been used sufficiently and effectively, is to point to the success stories of structural reform. All of this I intend to do in the following with regard to the most complicated field of structural reforms – the labour market – by looking at:

- first, measures to increase labour utilisation;
- second, measures to boost labour productivity growth, through education, technological diffusion and innovation.

IV.1 Structural reforms to increase labour utilisation and employment

Given the rather unsatisfactory functioning of the labour market in Europe at present, it is clear that stimulating labour participation and utilisation is a core challenge for policy. It is essential to provide incentives for more people to enter the labour market. If we take the decomposition in terms of age and gender of participation and employment rates, the situation of working age males is fairly similar across European countries and in the US (see slide 10 showing employment rates by age group and gender). We can infer from this that the problem of low labour utilisation in the EU derives mainly from the much lower participation and employment rates of females, the young, and older workers. Policy should therefore target these groups as a matter of priority, with a view to increasing their participation and employment rates.

However, if we consider that people might demand more leisure as their real income levels go up, it is clear that an increasing use of labour both in terms of employment and hours worked does not necessarily imply a welfare improvement. What I am referring to is the – by now well-known – argument that Europeans tend to favour extra leisure over additional income, whereas Americans prefer extra income over more free time. In my view, this proposition is not so clear-cut and requires careful interpretation. Rather, it is likely that the low levels of labour utilisation observed in some European countries compared to the US (as reflected by lower employment rates and hours worked), have more to do with the pervasive influence of tax and benefit policies on incentives, both to hire and to take up work, than with differences in preferences for leisure.

This observation points to the areas where policy action is urgently required. In addition to fostering the participation of female, young and older workers, the measures needed to improve labour market performance can be regrouped into two broad categories. First, policy should address perverse labour supply incentives that are inherent in tax and benefit systems, such as the levels of unemployment support or tax wedges. Second, it is necessary to carefully assess labour market regulations that may overly protect the employed at the cost of the unemployed.

To some, this reform programme may sound like a “mission impossible”. It need not be. Some countries have started to implement the needed reforms to reduce the disincentives to work that are currently present in many European labour markets. Unemployment schemes have been amended and early retirement incentives have been reduced. As a result, and despite the global economic downturn in 2001, the employment rate in Europe rose from 62.5% in 1999 to 64.3% in 2003 and seven Member-States of the EU-15 are set to meet the interim target of 67% by 2005. Take Sweden and Denmark: both countries have already exceeded all EU employment targets including those for women and for older workers, and their respective unemployment rates stand below 6%. To achieve these objectives, these two countries have carried out various reforms to improve work incentives and avoid labour supply constraints. In Sweden, the reforms mainly targeted the older workers, the immigrants and the younger workers in order to make work a real option for all. In Denmark, the measures have mainly consisted of lowering taxes on labour in order to increase labour supply.

Evidently, more progress of this type is necessary across Europe to attract more people into the labour market, especially in the light of the challenge of ageing populations. The Kok report on *“Facing the challenge: the Lisbon strategy for growth and employment”* contains clear guidance to this end. For instance, in order to increase female participation rates, disincentives for work for will have to be removed and equal opportunities should be promoted. In certain EU countries, the childcare system would need to be expanded, and more flexi-time should be introduced in the work organisation.

With regard to increasing the participation rates of the young, measures to foster lifelong learning or a greater efficiency of the educational system would help. A key measure in this area, which is also recommended by the Kok Report, is that Members States adopt, in close cooperation with social partners, national strategies for lifelong learning by the end of 2005.

Finally the low participation rate of older people could be addressed by providing incentives for workers to retire later in life and increasing incentives for employers to hire and retain older workers. That this can be done successfully is shown by examples in Spain and France where systems exist to allow workers to continue work on reduced hours after reaching the statutory retirement age as a form of gradual exit-from-work strategy.

IV.2. Boosting long-term labour productivity growth

Boosting labour productivity growth is another central component of the efforts to enhance Europe's growth potential. Innovation and technological diffusion have an important role to play in this context, and they are an important plank of the Lisbon strategy, which, *inter alia*, pursues the objective of making Europe a knowledge-based economy.

With regard to labour productivity, several measurements have shown that the overall level and the growth rate of hourly labour productivity are currently higher in some European countries than in the US. However, as I have already mentioned, the average annual hours worked and/or the employment rate are significantly lower in EU countries than in the US. When the diminishing returns to these two variables are taken into account, we can obtain a "structural" hourly productivity level, which is adjusted for differences with regard to the US in terms of hours worked and employment rates (see slide 11 on "structural" hourly labour productivity in the euro area relative to the US). What we see is that the "structural" hourly productivity level is higher in the US than anywhere else in Europe, which suggests that the US is still at the cutting edge of the technical efficiency frontier.

If we decompose labour productivity growth in Europe and the US by sectors, and notably by ICT-producing, ICT-using, and non-ICT sectors, it becomes obvious that the better labour productivity performance of the US economy mainly reflects particularly strong improvements in specific ICT-using business sector services (see slide 12 on the sectoral decomposition of productivity). The retail and wholesale trade sectors and financial intermediation stand out with their performance. The structural characteristics of the American economy were apparently more conducive to exploiting the opportunities provided by new technologies. In contrast, the sectoral productivity growth performance in Europe was characterised by a lack of technological diffusion across sectors, in particular in the service sectors.

Empirical studies dealing with labour productivity, technological diffusion and structural reforms have shown that regulations limiting product market competition, for instance by imposing entry restrictions and/or limiting entrepreneurial activities have negative repercussions on technological diffusion and labour productivity. The same is true for regulations affecting labour market adaptability, including in particular hiring and firing rules.

These insights have been applied to policy. All EU countries have made significant progress in product market reforms during the 1990s. These reforms are having positive effects on the integration of, and level of competition in, goods and services markets (see slide 13 showing labour productivity by sector in the euro area and the US). And the reforms do pay off: the remarkable labour productivity growth performance in network industries in Europe over the last 10 years, for instance, provides a perfect example of the positive impact on labour productivity growth of easing regulations and fostering competition. Indeed, in parallel to the significant steps taken in the past decade towards freeing up competition in network industries such as the telecommunication sector in Europe, labour productivity growth tended to significantly accelerate and to perform better in these industries, both in comparison to other sectors in Europe, and to the US.

That said, barriers to competition and innovation in Europe remain. And they need to be tackled urgently. Further reduction of these barriers in the Internal Market, in particular in services, is essential for promoting effective competition across Europe, and, in this way, for boosting labour productivity growth. The European Commission Directive on Service sectors, which seeks to cut administrative burdens and excessive red tape that can currently prevent businesses from offering their services across borders or from opening premises in other Member States, goes in the right direction. I would expect this to have a positive impact on innovation, technological diffusion as well as labour productivity.

Another essential factor of technological advancements and diffusion is the improvement of human capital. Indeed, thanks to technological advancements, economic activity becomes increasingly knowledge-based and jobs shift from low to high-skilled workers through the process of “creative destruction” I referred to earlier. So far, investment in human capital development in Europe is obviously insufficient (see slide 14 showing the educational attainment of the population aged 25-64). For instance, the numbers of European school-leavers who go on to complete higher education are manifestly inadequate for the knowledge-intensive economy. In Europe, only Finland, Ireland and Sweden have reached a comparable level to the US in this field. Improving human capital in these countries went along with a fast development of the ICT sector. As a consequence, they enjoy a labour productivity growth performance which is significantly above the EU average. Investment in human capital must therefore clearly be encouraged in the rest of Europe.

Finally, I would like to stress a rather obvious fact, which is not yet sufficiently recognised in practice: along with improving human capital, another key factor for promoting innovation and technological diffusion is Research and Development (R&D). As suggested by new growth theories, most innovations result from entrepreneurial activities or investments in R&D. And in this field, Europe clearly suffers from a lack of private investment (see slide 15 charting investment in R&D as a percentage of GDP). The Lisbon Strategy set a target that R&D spending should reach 3% of GDP; however, only two countries currently exceed this level, and in both these cases, business is achieving the goal of spending the equivalent of 2% of GDP on R&D. All the other EU countries lag behind. More efforts are clearly needed, as also urged by the Kok Report.

IV.3. Macroeconomic stability to support higher and sustainable growth

As mentioned earlier, the supply-side determinants of long-term growth that I have emphasised should not be understood as an exhaustive explanation for the growth performance of the European economy. Just as Ludwig Erhard was very conscious of the fact that stable macroeconomic conditions provided the very foundation of post-war Germany’s Social Market Economy, we should also look beyond the microeconomics of the supply-side and ensure an appropriate macroeconomic framework in Europe. Allow me to make a few brief comments on fiscal policy and – closest to home – on monetary policy.

Sound public finances are conducive to growth in a variety of ways. Through various channels, including confidence effects, prudent fiscal policies contribute to lower risk premia on long-term interest rates and thus to more favourable financing conditions. This, in turn, promotes investment and long-term growth. Sound fiscal policies also create room for manoeuvre to cushion the effects of the economic cycle. Finally, by reducing the burden associated with debt servicing costs, fiscally prudent governments have more scope to support economic adjustments, for instance in the labour market. It is ultimately for these reasons – to have a stable and sustainable fiscal framework for economic growth as well as for the support of a stability-oriented monetary policy – that the EU has adopted the Stability and Growth Pact. The respect of the Pact is in the enlightened self-interest of all Member States.

Beyond that, the "quality" of public finances also matters for growth. The level and composition of government taxes and expenditures has an impact on the way markets function, and they can hinder – or promote – growth. If inefficient public spending can be reduced, this can pave the way to finance tax cuts. And public expenditure directed towards productivity-enhancing physical and human capital accumulation rather than towards propping up failing enterprises or "sunset industries" is, of course, growth-promoting.

Finally, what is the role of monetary policy in fostering faster and sustained growth in Europe? I believe I do not need to explain in any detail to such a knowledgeable audience, why we at the ECB insist that the best contribution monetary policy can make to growth is to maintain price stability. What a central bank can and should do is to avoid, to the extent possible, the negative effects on long-term growth of the increased uncertainty caused by high, variable and unanticipated inflation. The variability of inflation increases uncertainty and exerts a major negative influence on investment and thus on potential output as well as on other components of aggregate demand. The environment of price stability and the level of short-term interest rates and long-term bond yields at present – the lowest since the Second World War – are clearly providing very favourable financing conditions lending support to economic activity. But – as another German economics minister, Karl Schiller, once remarked, paraphrasing Keynes – "we have led the horses to the water, but we cannot make them drink".

Moreover, there is another dimension to the relationship between monetary policy and economic growth. In an economic environment in which labour and product markets function more flexibly and efficiently and adapt more quickly in response to shocks and policies, the single monetary policy can maintain price stability and help support economic growth much more effectively. As a result, the implementation of supply-side structural reforms and the conduct of a stability-oriented monetary policy affecting aggregate demand can have mutually reinforcing favourable effects on Europe's growth performance.

V. Concluding remarks

The Lisbon agenda incorporates the relevant priorities to promote long-term productivity growth and to increase labour utilisation as an essential means for making Europe more competitive and dynamic. Some progress has been made to this end and it is reflected in the performance of some European economies. Overall, however, the implementation of the necessary reforms needs to be stepped up considerably to deliver the results laid down in the Lisbon agenda.

In this endeavour, most individual Member States have made so far progress in one or more of these policy priority areas but none has succeeded consistently across a broad front. It is important to bear in mind that only comprehensive reforms can be effective in promoting higher sustainable growth. Measures which target one single determinant of per capita growth will inevitably affect also other factors, via multiple spillover effects. Thus, while it is necessary to implement specific reforms aimed at improving the contribution to growth from specific factors, interactions must be kept in mind.

Another important point is that greater emphasis must be placed on involving the European social partners and on informing and convincing Europe's citizens about the benefits of structural reform. A better understanding of these benefits will lend support to their implementation and raise consumer confidence in the future, and thus also help the ongoing recovering of the euro area economy.

Let me conclude by returning to Ludwig Erhard. He is known for the following, somewhat ironic description of the art of finding the right compromise:

> *„Ein Kompromiss, das ist die Kunst, einen Kuchen so zu teilen, dass jeder meint, er habe das größte Stück bekommen.“ [“A compromise, that is the art of sharing the cake in such a manner that everyone is convinced that he has gotten the largest piece.”]*

He is, of course, right. The politics of reform sometimes require making and selling compromises. Europe, however, is at a critical juncture where further reforms are indispensable and where bolder decisions have to be taken. As we succeed in increasing the size of the cake, difficult decisions will become easier. Which brings me back to my initial reference to Ludwig Erhard and his insistence on policies that provide space for competition and individual freedom and that lay the foundations for the growth that will generate prosperity for everyone and – I add – make Europe the most competitive and dynamic economy. I start to think that Ludwig Erhard must have been to Lisbon more than once…

Thank you very much for your attention.