

**OPENING REMARKS AT THE EUROPEAN SUMMER
SYMPOSIUM IN MACROECONOMICS
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It is a source of great satisfaction to be able to hold the CEPR **Summer Symposium in Macroeconomics** for the fourth time here in Roda de Bará, under the auspices of the Banco de España.

As you know, the Banco de España is one of the central banks traditionally to have maintained close links with the academic and research community. Likewise, it has sought to promote, within the limits imposed by its resources, the pursuit of research applied to economic policy problems and fluid relations between policy-makers and analysts and researchers.

With the creation of the European System of Central Banks (ESCB), many things are going to change for the participating national central banks (NCBs). And although NCBs will retain many of their traditions, the culture underlying monetary policy conduct will gradually become more uniform.

Under a new common culture it is to be hoped that one tradition of certain central banks will remain to the fore; namely, that the art of monetary policy management will be based on the results of rigorous analytical and empirical work and that it will continue to ensure enriching communication with institutions specialising in applied economic research. Notable among such institutions is the **CEPR**, which has attained much-deserved prestige as a

catalyst for scientific research, casting light on the major challenges facing European economic policy.

The surprising course followed by European Monetary Union (EMU) is a paradigmatic example of the interaction necessary between the design and implementation of economic policy projects and the implications that arise from their analytical consideration.

EMU is a financial engineering project whose scope and scale are unprecedented in the history of economic policy. Fundamentally, it is politically driven and is a key part in the complex process of European integration, as such integration has been conceived. Yet implementing such a process it poses serious problems which, if left unresolved, might ruin the entire project. Then, what is initially seen as a step towards greater integration might become the cause of a serious setback. Hence the importance of all aspects of this complex project being consistent with the results of a rigorous analysis of economic reality.

As almost always in history, the EMU Project, as it is being applied, is the outcome of a compromise between the constraints imposed by political decisions and the conclusions reached from an analytical treatment of the problems. The exceptional nature of EMU has fascinated the academic community in many areas, but particularly in that of economics. Immense academic research has been done, addressing not only the guiding principles of the project or the major problems regarding its viability, but also the more

specific details of the institutional transformation that EMU involves. The analytical input of the academic community has been commensurate with the scale of the challenge. In turn, the vertigo political leaders have experienced in the face of the complexity of EMU has led them to be particularly sensitive to the recommendations and warnings given by academics and by monetary policy specialists.

The interaction has worked reasonably well in both directions. Indeed, it has perhaps contributed to the fact that EMU, though faced with such scepticism, is to come on stream on schedule and with a large number of countries. This is as the project was originally conceived and sidesteps the risks that a dual-speed launch -with an initial core of countries without sufficient critical mass- would have entailed. I referred to the risks and problems such a situation would involve at the opening of this Symposium two years back, here in Roda. We can affirm today that these risks have been overcome thanks to the headway made in convergence. And fortunately so, especially for the peripheral economies, which could have been excluded and left in a highly vulnerable position.

The acceleration of the process obliges us to face new problems, on which reflection is still at an incipient stage. In what remains of my address I should like to set out some of these problems. It is my wish that detailing such problems may act as a spur to their being tackled in the greatest depth possible from an analytical standpoint in the immediate future.

The first set of problems calling for a more penetrating analytical reflection capable of prompting workable economic policy proposals will arise from applications of the single monetary policy for the whole of the euro area. Here, initially, there will be eleven national economies with full power over the remaining preserves of economic policy. The likely persistence of cyclical disparities, the possibility of asymmetric shocks, the differences between adjustment mechanisms and the possible lack of homogeneity in the transmission of the single monetary policy to the various national economies all raise many issues.

Most notably the following:

- First, identifying the margin for manoeuvre actually available for national macroeconomic policies to harmonise the position of the national economies with the single monetary policy stance, which will be determined by the needs of the euro area as a whole.
- Second, identifying the factors which may determine the width of this margin.
- Third, the potential strategies for optimising this margin.
- And last but no least, the role microeconomic policies may play in prompting a greater capacity for adjustment via market mechanisms as opposed to adjustments traditionally induced by macroeconomic policies.

Within this range of issues, the need for clarification is pressing in the following areas.

In the case of national budgetary policies, it is crucial to design strategies and mechanisms that make the use of such policies as a stabilising instrument at the national level compatible with sustaining the necessary discipline for the smooth working of the single monetary policy. Foreseeably, the countries that make the most rapid and ambitious headway in fiscal consolidation, by harnessing the cyclical upturn, will be best placed to tackle this problem. Merely making the Stability and Growth Pact more flexible would not provide a lasting solution.

The question arises at the supranational level of the need for international transfer mechanisms to offset possible transitory asymmetries. This problem was raised during the negotiation of the Maastricht Treaty and by the Commission in the study "Stable Money and Sound Finances". The inefficiency in the Community budget, political disputes over the structural and cohesion funds and the serious problems that distributing the cost of EU enlargement involves led to the postponement of deliberations to introduce any such mechanism. Yet for EMU to work smoothly, some supranational stabilising instruments on a greater scale than those currently in place will be needed.

In the labour market, wage flexibility will play a pivotal role in preventing mismatches and asynchronies translating into losses in competitiveness and

output and employment adjustments. Irrespective of the different situations in member states, EMU will automatically entail a move to a situation in which wage bargaining, both EMU-wide and compared with the present arrangements, would tend to be more centralised. This process could follow from the monetary integration of countries that were formerly segmented. There are significant risks involved in this change.

It is in fact difficult to conceive of a centralised bargaining mechanism for EMU. Such a framework would enormously hamper consideration of the productivity differences prevailing among EMU countries. It could prompt an artificial and damaging process of wage levelling, unwarranted by the course of fundamentals. And it might, eventually, introduce rigidities into labour markets, countering the necessary move towards greater flexibility.

A second set of problems derives from the design and implementation specific to a single monetary policy in an area initially comprising a bloc of varied national economies. The final aim of this policy is clearly defined: price stability across the area. Drawing up a monetary policy framework which is suited to this situation, and in turn transparent, credible and efficient, is a much more complex issue.

Firstly, EMU entails a structural change on such a scale that it is impossible to use models estimated by simply aggregating national variables to predict the potential relationship between the financial variables of the Union -which the ECB can influence- and the final behaviour of prices. The

ECB will define and execute the Union's monetary policy with great pragmatism and inevitably with some discretionarity. There is a high risk that diagnosis-related errors will be committed, leading to mistaken reactions. Abundant empirical research into the relationships between the main macroeconomic variables in the Union as a whole will be of paramount importance in the coming years.

Unlike all monetary policy practice to date, the ECB will have to implement the common monetary policy while at the same time beginning to prepare initial estimates of aggregate variables for the area as a whole. These initial estimates will be of a notably lesser quality than those at national level, as statistical harmonisation is at a very incipient stage. In turn, the ECB will have to use a multi-country econometric model, entailing serious estimation difficulties. Accordingly, its results will be subject -at least at first- to considerable margins of uncertainty. The simultaneous handling of variables and indicators, at national and Union-wide level alike, will be a continuous source of delicate problems of interpretation. These will require in-depth research into interaction processes among the national economies participating in the Union. Against this backdrop, knowledge of the transmission mechanisms of the single monetary policy to the entire area and of the role of the various channels through which it is transmitted in each national economy will be of great importance. This constitutes a thoroughly new research programme on which the ECB and the NCBs will work intensely, but which will also arouse the interest of academics and researchers.

A third set of problems concerns the particular structure of the ESCB, where decision-making unity will concur with the decentralised implementation of monetary policy. Here, too, new ground will be broken. No central bank currently conducts all its operations via eleven operational centres acting in different geographical zones of the integrated area.

Here, there are endless practical problems which have undoubted analytical implications. These problems affect, inter alia: the structure of the decision-making bodies and their role in terms of communication and accountability; relations between the NCBs and the ECB; the changes in the NCBs' balance sheets in relation to monetary policy implementation and to financial flows between member states; and the implications of these changes for the distribution of monetary income among the participating countries. Many more aspects could be added.

In any event, the list of upcoming problems is clearly extensive and full of intellectual challenges. True, the programme for this Symposium is devoted to an extensive range of issues, of which a good number differ from those I have mentioned. But I would not wish to miss this opportunity to encourage this privileged gathering of eminent researchers to use their ability and energy to tackle rigorously the challenges EMU poses. We have what is perhaps a unique opportunity to achieve results that may be used to guide economic policy decisions in the future. I am sure you will seize it.