

# Editorial



Prof Dr Klaus F. Zimmermann,  
President of the German Institute  
for Economic Research, asks:

"How can Europe  
fight unemployment?"

*Since 1 January 1999 the euro has been a legal tender, as yet alongside national currencies, in most countries in the European Union. Although the new common currency has depreciated against the dollar, this has hardly been a problem, given sluggish economic growth in most of Europe. The internal value of the euro has been stable, with inflation rates being very low, and there are no signs of inflation accelerating seriously in the euro zone. Economic growth is expected to be 3% in the year 2000, but there is no justification for restrictive signals on the part of the European Central Bank (ECB). Unfortunately, the ECB may decide – in order to establish a reputation as a monetary hawk – to raise interest rates prematurely this year.*

*With the Maastricht Treaty, European countries left a substantial portion of their macroeconomic policy instruments in the cloakroom of economic history. They handed over monetary policy to a group of experts whose sole obligation is to fight inflation. The Stability and Growth Pact, which keeps national fiscal policies on a tight rein, is both testimony to the victory of conservative macroeconomic policy and an instrument to reinforce it. It is surprising that fiscal consolidation has been achieved in the face of high unemployment and that it has been possible to maintain it despite the coming to power of left-of-centre governments in many European countries.*

*Yet macroeconomic stabilisation is essential in the fight against European unemployment, both because fiscal consolidation is a prerequisite for economic reforms and because of the interaction between structural and cyclical unemployment. In a recession, unemployment tends to rise highest among the low-skilled. The human capital of the unemployed depreciates, reducing their chances of re-employment. Thus, although structural issues are certainly involved, it will be impossible to solve the unemployment problem without an extended period of substantial economic growth. This is the lesson we can learn from the USA. As such, the demand side remains crucial for any constructive economic policy approach towards fighting unemployment.*

*Last year the German economy grew only sluggishly. Another year was lost in the fight against unemployment. The situation for 2000 looks more promising. The DIW expects a growth rate of around 2.4%, largely on the back of exports. Furthermore, the government's plans to cut taxes substantially in 2001 may stimulate domestic investment and consumption already this year (see the DIW prognosis in this issue). This cautiously optimistic prognosis is subject to two main risks, however. One is that the boom could end in the USA, leading to higher interest rates there and hitting German exports. The other is that the ECB could raise interest rates too early. We therefore recommend measures to ensure stable growth rates close to 3% in the medium term in order to achieve a lasting reduction of unemployment.*