FRANKFURT—European Central Bank President Mario Draghi called on governments Thursday to take forceful action to spur investment, including the provision of state guarantees for small-business loans and beefed-up public investment spending by governments that can afford it.

"If we don't manage to get investment going again, we will weaken the economy in the short run and undermine its prospects in the long run," Mr. Draghi said in prepared remarks to a conference in Milan.

His comments came one week after the ECB surprised financial markets with a reduction in its key interest rates to fresh record lows and the launching of programs to purchase private debt securities such as asset-backed securities and covered bank bonds.

The ECB took these measures to prevent low levels of inflation from persisting too long, which would weaken the economy by draining profits and making it harder for the private and public sectors to service debts. Annual eurozone inflation was 0.3% last month, far below the ECB's target of just under 2%.

But despite the ECB's aggressive actions, Mr. Draghi signaled the central bank can't foster economic growth on its own. "Only if structural, fiscal and monetary policies go hand in hand will the euro area see investment return," he said.
Mr. Draghi said some governments should remove barriers to investment that are embedded in regulatory red tape. "In many cases, these obstacles sap entrepreneurial spirits, especially of young, innovative firms that create most of the new jobs and that are highly sensitive to changes in investment opportunities," he said.

He also called for state guarantees of certain small business loans, noting that this practice is used in the U.S.

European governments also should search for ways to boost public investment without running afoul of existing budget rules, Mr. Draghi said, reiterating comments he made last month.

"It may be useful to have a discussion on the overall fiscal stance of the euro area with the view to raising public investment where there is fiscal space to do so," he said. Although he didn't name specific countries, many economists think Germany is an ideal candidate for stepped-up public spending on investment, given that its budget is roughly in balance and it can borrow at near record-low rates.

Turning to the ECB's role, Mr. Draghi said the central bank will start purchasing asset-backed securities and covered bonds next month.

Although he didn't specify an amount, the purchases—in combination with previously enacted low-interest rate loans to banks starting later in September—"will have a sizable impact on our balance sheet, which is expected to move towards the dimensions it used to have at the beginning of 2012," he said.

The ECB's balance sheet was between €2.7 trillion and €3 trillion in the early months of 2012. It has declined steadily since as banks made early loan repayments under a previous ECB lending facility. The balance sheet was just over €2 trillion last week.

The ECB "stands ready to take further action if needed, in compliance with its mandate to maintain price stability," he said.

With Mr. Draghi recently conceding that interest rates can't be cut any more, and private-sector asset purchases in the pipeline, many analysts think the next step would be large-scale purchases of government bonds. This policy was used extensively in recent years by central banks in the U.S., U.K and Japan.

But other comments by top officials suggest the hurdle remains for the ECB to follow suit.

On Wednesday, ECB executive board member Yves Mersch said "the purchase of government bonds would raise substantial institutional, instrumental and legal questions."

In an interview with German newspaper Boersen-Zeitung due to be published Friday, ECB Vice President Vitor Constancio said that while buying government bonds is an option for the ECB, it would prefer not to be forced into such a step.

—Todd Buell contributed to this article.

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