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Interview with António Vitorino

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Europe seems to be systematically postponing decisions, while economists like Roubini say that a restructuring of Greece's, and even Portugal's, debt is needed. Is there a way forward for such a Europe?

There is and there must be. The decisions are going in the right direction, in the sense that they show European solidarity towards exposed countries, and also in the sense of strengthening the Economic and Monetary Union's (EMU) cooperation mechanisms. These two points are fundamental – emergency measures and the foundations of a more solid EMU architecture. We can criticise the pace of decision-making, and also the ineffectual implementation. The decisions of 21 July are still not in force despite a dark August. This proves that the pace of political decision-making is totally unsuited to that of economic markets. Most worrying is that policy is falling victim to a "catch up" complex, trying without success to catch up with the markets.

How can this situation be reversed?

First of all it is necessary to see far and wide – a short-term vision is not enough. We must not have an exclusively alarmist outlook. This is a question of applying the European semester – until now forgotten in the debate. Coordination of national economic and budgetary policies is essential if an economic pillar is to be added to EMU. Without such coordination and convergence it is not possible to answer the central question – that is, the gaps in competitiveness between the countries that share the single currency.

A European vision is lacking, then?

What is lacking is an overarching vision, and leadership.

In Portugal too?

Portugal has a programme to implement and it must do so correctly – this is the agreement with the troika. The problem is that this is essential but insufficient. The Portuguese government proposes to go further than the troika's demands, which is a way of seeing things but not mine. One part of Portugal's programme concerns the EU. Notwithstanding the declarations of the German finance minister (who said in a *Financial Times* article that what is needed is "austerity, austerity, austerity") the solution is to uphold the planned austerity measures, to put public finances in order, and at the same time to create the conditions for economic growth. This perspective of economic growth is missing in the European context, and here Portugal's policy depends on Europe's.

And that is missing in the troika agreement?

My predecessor at the think tank *Notre Europe*, Tommaso Padoa-Schioppa, would say: "Austerity for the states, growth for the Union". The stimulus for new economic growth must be given by the EU, using various mechanisms – eurobonds, new financial perspectives and the mechanism for anticipatory and flexible use of structural funds until 2013, in particular for countries faced with economic adjustment programmes whose recessionary effects need counterbalancing.

[*] *Translation by Notre Europe. The major parts of the interview are published here.*

The structural funds are already being made more flexible.

Not as much as is needed. The Commission proposed making the 2007-2013 funds available anticipatory. But they need to be made more flexible in terms of bureaucracy and as far as their national component is concerned. We have a serious problem of restricted public investment, of liquidity lacking in the banking system. This void must be filled by more intensive and flexible use of structural funds, and that depends on Brussels.

The ill-adapted pace of policymaking

But that will encounter resistance from several states.

Which is why the basic task of those who believe in Europe, and of the Portuguese government, is to convince reticent countries that this is a question of the European strategic interest and is not simply about resolving the problems of over-indebted countries.

And how can we convince Ms Merkel?

Ms Merkel shares responsibility for the clearly insufficient pace of decision-making in relation to the demands of the market. But if we look at the position of the 27 member states on EMU over the last three years, the country which has changed the most is Germany. The European Central Bank (ECB) has bought sovereign debt; the European Financial Stability Fund does not only provide triple-A guarantees to over-indebted countries (impossible without Germany) but since 21 July it has been authorised to acquire public debt on secondary markets. Germany has also accepted the principle of European economic governance, which was a completely taboo subject during the Convention. In a shared monetary zone, competitiveness imbalances must be corrected both by improving the performance of uncompetitive countries and by increasing demand inside exporting countries.

There is this theoretical understanding, but a practical side is missing. The truth is that the legislative package on economic governance has been waiting for approval by the European Parliament for a year.

We return to the same point: the direction is the right one, the issue is speed. Lost time must be made up. Markets always move faster than politicians, which reveals a major vulnerability of our democratic systems, which are ill-adapted to a world of economic globalisation – and above all financial globalisation. Numerous essential financial instruments escape the control of authorities at national, European and world levels.

There are no surgical solutions

How can we change this situation? In the meantime Greece may collapse.

I think that Germany and the whole EU will do everything to stop Greece collapsing. I am deeply convinced of that, but it is indispensable that Greece does its share of the work. Everyone has a share of the responsibility. Were Greece to default or ask to leave the eurozone, we would be opening a Pandora's box. No-one really knows what would happen. We are in uncharted waters.

Contagion would be inevitable, not only in countries receiving financial assistance but also – as the markets have shown emphatically in recent weeks – in Spain and Italy, which completely changes the scale of the problem. And we are witnessing a worrying contagion effect among French banks. Today it is possible to say with some certainty that a Greek default would produce shock waves and contagion which would affect all eurozone countries. I am convinced that it is in the German national interest, as well as the European interest, not to allow Greece to default, in the continuity of what was decided on 21 July.

Will Germany have to face this decision on 29 September?

Yes, it's a package with several components which conflict with Germany's traditional position.

Despite this conviction and this analysis, many people claim that the best solution would be to let Greece default and even to allow it to leave the eurozone.

It is illusory to think we could mount a surgical operation within the eurozone. A year and a half ago it might have been possible to negotiate the conditions of its exit from the eurozone and allow a debt restructuring. Today, given the contagion effect already noted, and given that the credibility of the whole eurozone is in question, that is no longer possible.

So Greece is either with us or...

Or the single currency's very existence is in question.

No to federalism

The only way forward involves greater integration – more federalism or more centralisation?

An open debate on federalism would be opportune.

Are you federalist?

No, and I never have been. Building a theoretical federal model would be a leap forward, totally unrealistic and not viable in practice.

Europe's peoples would not accept it?

There is growing scepticism towards the EU, and growing doubts over the ability of national and European institutions to manage this crisis. In an environment of economic crisis, unemployment, recession – and I think that by the end of this year all of Europe will be in recession, including Germany – it is unrealistic to demand a qualitative leap towards some fully-fledged project of federalism. It is however possible to move towards better economic coordination so as to fill the inherent void in the EMU.

Small steps

Specifically?

Certain measures are on the table, at the European Parliament. Secondly, we have the European semester, which has been forgotten but is still in force. It is a package of recommendations to strengthen economies, innovation and research and to create jobs. Next spring we will have the first assessment of how member states used collectively-produced recommendations in formulating their domestic policies – this could be called European economic government. A third dimension involves eurobonds and new financial perspectives.

We will not have a federal budget of federal dimensions. It is possible that the Commission's proposal will lead to a strengthening of own resources, in particular via the proposal for a value-added tax adapted to European purposes or a tax on financial transactions. This debate must take place because such resources will allow European economic coordination to be sustainable.

Are eurobonds the necessary solution?

Either eurobonds or euro project bonds. There is much confusion over these instruments, as if they were substitutes for austerity or spending reforms. This debate will not remove the need for austerity in public finance, but these instruments can – even if it will take time – send a clear signal to markets that European states were serious when they said, at the start of the Greek crisis, that they would do everything to save the euro.

An EFSF of € 440 billion or even € 700, as planned for the future European Stability Mechanism (ESM) will not bring this guarantee. Only a bond market can do so. It would be a signal and an alert that there are limits to pressure on the euro and to the potential for speculating against it. We are placing all the burden on the shoulders of indebted countries, forgetting the converging pressure on the euro caused by the market and those who earn a lot of money from speculation. The first task of such a bond market would be to stabilise the euro's macro-financial market.

The only solution

What's missing, therefore, is a firm hand

That's why I say that the decision must be taken, even if not straight away. Putting a European bond market in place, in which bonds would be issued by the EU or member states collectively, will take time and demand technical studies.

The Commission has committed itself to studying the launch conditions for such a market, using different scenarios. Some involve modification of the treaty, which is difficult, but others do not. Another dimension concerns euro project bonds, which are debt issued centrally for European investment projects – in areas such as energy, telecommunications, transport – which would have the effect of catalysing job creation and improved European competitiveness.

Essentially this would be European debt, contracted in close cooperation with the European Investment Bank, which would allow economic growth to be added to austerity. It is the only solution. Europe must achieve growth, that is its only challenge. The challenge is not new and not a result of the sovereign debt crisis – which simply made more obvious a problem that existed already.

Growth over the last decade has been anaemic. Many have said that the Lisbon Agenda did not produce results, and the Europe 2020 strategy is Lisbon's heir. But this component cannot be put aside, since all of us – political leaders, medias, citizens – are living with the anguish of what is happening each day on the markets.

There are no easy solutions

It would be very damaging for the euro's image, as Europe's main currency, not to be able to accommodate the sovereign debt crisis of three countries which together represent only 6% of the European economy. The lost time has meant that the crisis has affected Spain, which represents 12%, and Italy (15%), and that means that a third of the European economy is now affected by market pressure over the question of debt.

And why have we let the issue drag on like this? Because of the resurgence of nationalism?

As Europe's economic crisis has deepened, tensions have appeared between North and South, and the Schengen agreement among others has come into question. It's a sign. All of these crises lead to the growth of protectionist feelings.

A Polish minister has even talked about war

I would not go so far and I hope humanity can learn from its mistakes. The European project is a product of the second world war and its aim is that such a situation never occurs again. But we cannot deny the growing strength of protectionism, which feeds nationalist and xenophobic sentiments. Schengen is a good example of how, outside the economy, there is pressure to control the movement of people at borders. And let's not have illusions: the issue will not end with people, it will quickly move to goods and services. It is the internal market which is beginning to be affected by these pressures.

It is not by chance that the United Kingdom has insisted on a solution for the euro zone's difficulty, whereas this country belongs neither to the euro nor to Schengen. The British government understands perfectly well that protectionist backsliding will affect the foundations of the single market – which is the key issue for the United Kingdom and its presence in the EU.

Democracy in question

Another question concerns democracy. Has it not been sidestepped by the mechanisms of economic governance? After all, only two states are "piloting" the process.

I have met people who believe that the Lisbon Treaty and the new system of voting in the Council are responsible for this Franco-German duopoly. But the truth is that the new weighting of Council votes is not yet in force.

The scale of the effort required to fight the problem of sovereign debt goes beyond the capacity of the annual EU budget, which amounts to € 110 billion. For the moment the EFSF has € 440 billion to face the problem of Greece, Portugal and Ireland.

The necessary financial resources can only come from intergovernmental cooperation. But there is no need to declare the end of the community system. After all, EU institutions are involved by necessity (the European Commission and the ECB have decisive roles). It is the result of the need to raise funds and guarantees on a very large scale. It will be necessary to guarantee national legitimacy, the approval by national parliaments of decisions taken by heads of state and government. There is a role for EU institutions but the scale of the crisis makes intergovernmental intervention indispensable. It's a slow process.

The future system of economic governance must by necessity rely on these two dimensions – institution-based and intergovernmental. It would not be possible today to create a federal budget at the disposition of the Commission, allowing it to manage the crisis. This solution would be a better one than a hasty jump towards federalism.

Is federalism a positive future possibility?

The ECB is already a federal institution, as is the single currency. I respect those who are demanding clarification over a final federalist model. But I don't think we will achieve this, and I don't think it is the right way forward.

Must the European project be refounded?

I already had this illusion with the Constitutional Treaty, because the move from 15 member states to 27 demands a relaunch. It was not a question of reinventing everything, but rather of giving new legitimacy to the project – that's why it was called the Constitutional Treaty. It did not transpire, because of everything that happened, and I too got older.

I will not use the extreme term of refoundation. I prefer the logic of small steps and improvement of existing instruments, even if this means innovating with institutions – for example, European economic government (at the Convention we worked on this and there was always opposition from the German government and parliamentarians).

It is fashionable to criticise Berlin, but even if this is justified we must acknowledge that the country whose position has evolved most in seven years is Germany.

There is no refoundation, but rather a new marriage of convenience.

I know of no marriage which does not face difficulties. The art is to overcome the difficulties and learn from them.

The EU would not survive

If the euro fails, will the EU fail?

I could not agree more with Ms Merkel on this point. Her speech to the *Bundestag* is the first far-sighted one. It is a commitment by Germany to the wider future of the European project. I have difficulty seeing how the EU would survive the collapse of the eurozone, in particular because of the signs of impact on the internal market. The euro is the glue which holds together the internal market.

But non-euro countries are to be found within the internal market.

Before the crisis those countries were looking to join the euro quickly, with the exception of the United Kingdom and Sweden. We have moved on and today it is not possible to surgically remove parts, i.e. Greece, of the European project. I neither wish for nor envisage a collapse of the eurozone, but if hypothetically it were to happen there would be devastating effects on other key elements of the European project – in the first place, the single market.

It would be the end of the EU. I therefore agree with Ms Merkel: if the euro fails, the EU fails, in its capacity as a global political and economic entity. In the face of international change the West is losing momentum, and the EU must be seen as an instrument to limit this relative loss of influence and to give us new elan.

(...)

Relations of Portugal towards Greece and Ireland

Portuguese policy, even that of the previous government, was to distance Portugal from the cases of Greece and Ireland, but that was of little use. Is this not a sign of a deep lack of solidarity?

Even if the first reactions were to try to create an apartheid in relation to affected countries (the PIIGS), we moved beyond this phase when contagion showed that the problem is global. Each case represents a different situation. Italy, for example, has a public debt of 120% of GDP. But it already had this when it was accepted into the eurozone. How? Because the institutions overestimated the value of deficit reduction and were indulgent on the debt criterion. It was unimaginable to exclude Belgium from the eurozone but Belgium's public debt was 100% of GDP. Neither could we have left Italy – founding member of the EU – outside the eurozone, especially given the Prodi government's deficit reduction by means of a special tax.

The contagion is global

Was that a political decision?

It was an indulgent assessment of debt figures, the responsibility of the institutions – the European Commission, European Council and the ECB. The importance of public and private debt figures was always underestimated. Each country is in a different situation. Greece has a public debt of 130-140% of GDP but a private debt which is less than Portugal's.

Spain is an exemplary case: at the beginning of the crisis it had a budget surplus and public debt of 40% of GDP. It was a virtuous country, which reveals the limits of the budgetary oversight criteria. Even today Spain has a public debt of 79% of GDP (Germany's is 85%). These figures must not be overlooked.

Italy's debt is in large part private, but as soon as contagion sets in, with doubts on the Italian state's ability to repay its debt, the effect is immediate on Italian banks, which hold much of the public debt, as well as on French ones. Calculations indicate that French banks hold around € 600 billion of debt in over-extended European countries, including Spain and Italy.

And Germany?

The figures for German banks are not completely known. But no-one will escape. It seems to me that no-one in the eurozone is suicidal, least of all Germany. A default by Greece or Italy – and analysts say that if Greece defaults then Italy will following, considering that Portugal and Ireland are marginal cases – would provoke a veritable tsunami in the financial system of central Europe.

And in the international financial system.

Of course. That is why Barack Obama is so concerned about Europe and why Timothy Geithner went to Poland to make an appeal. China has also asked Europe to put its house in order.

Is it not humiliating to hear this?

The situation is so serious that there is no room for moral judgements.

The left's difference

But this discussion also has a moral side: the virtuous Northern countries and the sinners of the South.

That's a caricature. Certain countries have debts but others were creditors who lent without worrying about the ability of indebted counties to pay. This paradigm is finished for everyone, debtors and creditors. Credit was promoted for everyone, countries and individuals. That era is over and will not come back. The challenge is to adjust: we must all learn lessons and adapt to a different world. The July package represents a "haircut" of 20% for the creditors, even if Roubini claims that it will be necessary to go as far as 50%. The creditors will assume a share of the losses. A first step has been taken, accompanied by negotiations over conditions. Perhaps it will not be enough. Even when Greece achieves a primary surplus (2014-15) its debt will still be higher than 130%, which will demand specific mechanisms. The Portuguese case is similar – our debt will increase to 106% before we start to reverse the trajectory.

Does the left have a different plan for Europe? Or has Portugal got into this situation because of liberal economics?

Most governments are of the centre-right, and some are supported by anti-European parties – this was the case in Denmark and is now true in the Netherlands, Sweden and Italy. So these parties will need to justify the current policies.

The centre-left parties with a vocation to govern share the belief that it is necessary to put public finances in order. The difference is that they attribute more importance to two basic ideological imperatives: economic growth and fighting inequality. The economic crisis is a factor of social inequality since it affects the least privileged most.

This whole debate on taxing the rich reveals how financial globalisation has profoundly reduced the capacity of member states to tax capital, in the absence of global tax mechanisms – which would have repercussions at the national level, because labour's share in national revenue is constantly decreasing.

(…)