

EXTRACT

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The Euro, the investors and the governance
Proceedings of the seminar in honour of Tommaso Padoa-Schioppa,
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Introduction

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Tommaso Padoa-Schioppa devoted a large part of his life to working on the European currency and global monetary organisation. His commitment to resolving the crisis that has been affecting the euro zone since 2009 did not come as such a surprise. Learning from past experience and stimulated by his vision of a future at once both uncertain and flexible, Tommaso fought to make the – somewhat lost – voice of Europe’s fathers heard, and to put forward effective and lasting solutions accompanied by proposals for strengthening the Economic and Monetary Union (EMU).

To pay tribute to this convinced and far-seeing European with his deep interest in economic and financial issues, *Notre Europe* and the Egmont Institute joined together to organise a seminar on “The Euro, the investors and the governance”. The seminar, held in Brussels on 4 April 2011 in the presence of some sixty personalities, allowed us to address issues that have been the subject of passionate debate since the global financial crisis first rocked the euro zone.

The seminar was held “behind closed doors” in order to allow the speakers, the debate chairs and participants in general to voice their views freely and without

fear of being quoted outside the seminar venue. I would like to take this opportunity to thank them again for the quality of their contributions to this collective discussion. This book contains only the addresses delivered at the seminar by the nine official speakers, with their agreement. It falls to me here to echo their thoughts and to summarize the debates triggered by their speeches, going on to then illustrate the lessons that I myself have learnt from them.

Any debate on the issues currently at stake in, and the solutions to be adopted for, the euro crisis must rest on an objective and stringent assessment of the experience that began in 1999, distinguishing the nine years before the crisis from the years 2008-11. Thus the seminar's first round table endeavoured to review the EMU's track record with speeches from Chairman Jean-Claude Trichet, Governor Mario Draghi and Germany's Peter Bofinger, a member of the "council of five wise men".

Taking stock is neither an easy nor an obvious exercise. The result is going to depend both on the way we look at things and on those aspects to which we assign a positive value.

The EMU was seen as a huge success ten years after its creation, and before the global financial crisis struck. The euro succeeded in rapidly winning market confidence and in getting established as the most important reserve and international transaction currency. Price stability was ensured, and member states were able to enjoy low interest rates. The euro gave Europe ten years of acceptable growth, with an average growth rate of 2.1% and the creation of 15% more jobs.

As Jean Boissonat, the debate's chair, explained, the public debt crisis had an edifying impact: it revealed the EMU's strengths, but above all its weaknesses. The speakers highlighted four of the latter in particular.

Firstly, the budget oversight framework offered by the Stability and Growth Pact was not sufficiently stringent. Several countries failed to meet the Pact's requirements without suffering any particular consequence for having done so.

Secondly, economic union, which was intended to complete monetary union, was non-existent. The absence of either economic policy coordination or macro-economic oversight meant that the EMU proved incapable of preventing major macro-economic imbalances among the countries in the euro zone.

Thirdly, the EU suffered from the inconsistency between a globalized bank system and national financial oversight mechanisms.

Finally, the EU had no crisis-resolving mechanism before the crisis, so it had to create one riding on the back of the emergency.

Yet the crisis did not reveal only the EMU's weaknesses, it also allowed member states to become aware of the interdependence that exists among the countries in the euro zone. The problem any given member state is facing cannot be limited to its borders; it affects the euro zone in its entirety. Thus the challenge that the European institutions and member states are now facing consists in creating appropriate oversight and coordination mechanisms in an effort to consolidate the limited shareout of sovereignties among the member states.

The EU has taken a firm stance on managing and resolving the crisis. Even though it has been criticized for taking a long time before swinging into action, numerous participants pointed out that the time-frame of democracy is longer than the time-frame of the markets, and that the responses given to the crisis must therefore be afforded proper consideration.

The debate organised during the seminar's second round table addressed the role and expectations of investors *vis-à-vis* the euro. François Lenglet opened the debate by pointing out that investors must not be seen as adversaries in the management of the crisis, and that it is important to foster dialogue between the players in the market place and the political decision-makers.

Investors were represented at this debate by Philippe Lagayette and Erik Nielsen. Their speeches were accompanied by an address from a leading political player and expert on these issues, Commissioner Michel Barnier.

The speeches pointed up the urgency of re-establishing confidence in the European banking system. This involves, in the short term, conducting a clear diagnosis of the situation in the industry through stress tests whose credibility is boosted both by more stringent conditions than those laid down after the first series of tests, and by the improved coordination provided by the new European Banking Authority. The tests must be a success and they must teach us a few lessons, prompting the adoption of the measures required to aid struggling banks to recover.

Despite the sweeping reforms of the past few months, the new financial oversight framework has to be strengthened even further. In particular, the powers of oversight of the new authorities which have just been set up must be strengthened.

Moreover, there are certain problems that have not been resolved yet, the speakers stressing in particular the regulation of bank bankruptcy and of rating agencies in this regard. The Commission must devise proposals designed to allow the implementation of the ground rules enshrined in “Basel III” and a tool box for the prevention and resolution of bank crises.

The issue that produced the widest rift among the participants concerned whether or not a country in the euro zone should be allowed to restructure its debt. On the one hand, a fair number of economists and investors argued that we must distinguish between liquidity and solvency problems and that we must allow for the possibility of an ordered restructuring of the public debt. Representatives of the European institutions, on the other hand, argued that it is not consistent to adopt serious financial and budget measures while announcing the hypothesis of some kind of “plan B” – debt restructuring – more or less in the same breath, because statements of that kind would undermine the credibility of the measures announced and render them ineffective.

The benefits that would result from the issue of euro-bonds up to a certain figure (for instance, up to the existing debt level or up to 60% of GDP) to fund national debts were mentioned. In that context, it was stressed that euro-bonds would have a positive impact, including for Germany, by guaranteeing greater solvency and liquidity. Those opposed to the idea pointed out that the European Financial Stability Fund and the European Stability Mechanism were already extremely difficult to achieve, even separating the risks, and that therefore the mutualization

of risks through the issue of euro-bonds sounds unrealistic. Besides, euro-bonds would be a huge step forward down the path leading to mutualization of a federal nature, which the member states are not yet ready to accept as things stand today.

The third round table focused on the EMU's future. Jean-Hervé Lorenzi, who chaired the debate, stressed that even though we are only now taking our first steps in the direction of genuine European economic governance, we will realize in a few years' time, when looking back, that the years 2010 and 2011 were exceptional years in terms of the proposals and decisions made. But we have not yet reached the end of our journey, hence the need to continue debating Europe's economic governance.

The debate was enhanced by speeches from Deputy Prime Minister Didier Reynders, from Mario Monti and from Jean-Pisani-Ferry.

The upshot was that budgetary consolidation is only one factor, albeit a crucial one, in emerging from the crisis. It is essential today to reconcile the return to stability with a growth strategy, so as to be able to respond to the dual criticism of markets clamouring both for a reduction in public and private indebtedment and, at the same time, for a reduction in the risk of economic stagnation in the event of excessive budgetary stringency.

Speakers mentioned two crucial conditions for imparting a fresh boost to growth in Europe: structural reforms, and a strengthening of the single market.

On the one hand, structural reforms are essential in order both to strengthen competitiveness, and to cover a weakness in the European economies consisting of relatively weak overall productivity. It was pointed out that structural reforms are not being implemented with sufficient vigour today, when in fact they should go hand in hand with healthy budget policies.

This issue brings us to the importance of considering not only the level but also the quality of public spending. It is best to distinguish between consumption spending and investment spending, because countries should be making investments designed to empower future growth.

In this context, the “Euro-Plus Pact” was greeted with enthusiasm because it may make it possible to bring forward the reforms needed to impart a fresh thrust to growth. The challenge facing us now is that the member states must prove as committed to its implementation as they have been to its adoption.

On the other hand, it was emphasized that the single market is an essential trump card for relaunching growth. In the context of Europe’s new economic governance, we cannot assign the EU a role consisting merely of overseeing and coordinating national economic policies. The EU must be a fully-fledged player in the relaunch of growth: its role is linked principally to the modernization and deepening of the single market, which has been and still is one of the principle driving forces behind growth in Europe.

The member states have learned their lessons from the crisis and they have taken the ambitious decision to strengthen the EMU, particularly through imparting new strength to the Stability and Growth Pact in the shape of gradual but more automatic sanctions, of a new macro-economic oversight procedure, and of a strengthening of the follow-up on structural reforms in the context of the “Euro-Plus Pact”. All of this represents considerable progress, but we should emphasize that it marks only the beginning of the path down which we need to travel. The most important thing will be implementing in concrete terms the measures being contemplated today, and implementing them in the long term. This year of reforms must be followed by those reforms’ equally intense implementation, and more especially by a genuine display of commitment on the member states’ part.

The member states will naturally be playing the leading role in the implementation of the measures adopted. The Commission is going to have to play a role based on initiative, follow-up and assessment. However, while bearing in mind the importance of actions undertaken at the national level, a proposal was also put forward to strengthen the Eurogroup’s powers and to extend its sphere of action. Thus the Eurogroup chairman could enjoy stronger powers in verifying that engagements entered into (in the framework of the Stability and Growth Pact or of the Euro-Plus Pact) are honoured. In addition to this, the Eurogroup could be developed further by planning meetings no longer devoted solely to economic, financial and monetary issues. Ministers with responsibility for areas of importance in the fields of com-

petitiveness and growth, such as employment, research, transportation, welfare or education, should also hold meetings 17-strong.

The creation of a permanent crisis-resolving tool, the European Stability Mechanism, was welcomed by most participants, although several weak points were identified. The mechanism can kick in only as a last resort, it is subject to a unanimous vote and it is bounded by numerous terms and conditions, and it will not be able to buy up debts on the secondary market. A number of participants highlighted the fact that this new mechanism should be allowed to intervene sooner in order to facilitate the adoption of programmes for the consolidation of public finances.

Finally, it was pointed out that the public debt crisis has also triggered a political crisis, which is translating in particular into the rise of populism in numerous countries. This movement may be fuelled by the enforcement of austerity measures, by lack of growth and job creation, or by the feeling that one is paying for others' mistakes. But this political crisis is due also to a communication problem and to the temptation to turn the euro into a scapegoat. If the EU is to counter the rise of populism, it also needs to learn to improve the way in which it communicates what it does and the progress it is making.

Tommaso Padoa-Schioppa thought that the deepest roots of the current crisis should be sought in shortsightedness, "the kind of sight, as Dante put it, that does not extend beyond a single issue, a shortening of the horizon on which the markets, governments, communication, businesses and even the man in the street, train their gaze". Our hope is that the collective debate conducted during this seminar may encourage people to cast their gaze beyond the short term and the immediate issues. As Jean Boissonat pointed out, we have to address this crisis with confidence because, as Jean Monnet said, "Europe will be forged in crises and it will be the sum of the solutions adopted for those crises".

In a nutshell, we must carry on the struggle of the past sixty and more years for a Europe united in diversity, a Europe at once strong, just and generous.

This text is extract of the Proceedings of the Seminar in honour of Tommaso Padoa-Schioppa, available in our website.

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The Euro, the investors and the governance

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Overall, Firstly, to conduct a thorough assessment of the project undertaken in 1999, while clearly separating the first nine years from the 2008-2011 period. Secondly, to respond to the doubt financial and monetary specialists have placed upon the future of the euro. What do investors expect from a common European currency? What do they dislike about the current system? Do they have any proposals for reform, be they institutional or technical? Finally, the third objective was to ascertain what type of EU governance will be able to guarantee both euro zone stability and European Union economic and social development (i.e. job creation, competitiveness and purchasing power).

This publication, a collection of the speakers' interventions, draws an outline of possible answers to these fundamental questions.

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