Vítor Constâncio: Strengthening European economic governance – surveillance of fiscal and macroeconomic imbalances

Speech by Mr Vítor Constâncio, Vice-President of the European Central Bank, at the Brussels Economic Forum, Brussels, 18 May 2011.

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Thank you very much for the invitation to participate in this panel today. The session is intended to focus on "surveillance of fiscal and macroeconomic imbalances", which arguably is the most important strand of the economic governance package. But one should consider that this package – beyond the 6 legislative acts – also contains three other strands: the Euro Plus Pact, the creation of the European Stability Mechanism and the setting-up of the European System of Financial Supervision. A fundamental strengthening of economic governance in the euro area requires simultaneous progress in all three areas. The first strand is necessary to prevent and correct imbalances; the second to ensure the conditions for future growth and competitiveness; the third to provide a last resort backstop if crises still occur, the fourth to guarantee financial stability, in particular in the banking sector.

That said, prevention and correction of fiscal and macroeconomic imbalances must be given priority as it is the pre-condition for sustainable economic growth and financial stability. As the ECB has stressed on a number of occasions, here a "quantum leap" forward is needed in strengthening the Stability and Growth Pact and creating an effective new framework for surveillance of macroeconomic imbalances.

Important negotiations are ongoing between the Commission, the Council and the European Parliament to reach agreement on the legislative package of economic governance reforms. For this agreement to reach the necessary "quantum leap", the following elements are essential.

First, greater automaticity is needed in all surveillance procedures, including the new macroeconomic surveillance framework. The Council should have less room for halting or suspending procedures against Member States. Strict deadlines to avoid lengthy procedures and the deletion of escape clauses would also contribute to automaticity. This is critical to ensure the credibility of the new framework and address spillovers in a timely manner.

Second, enforcement tools need to be more effective. In addition to financial sanctions, political and reputational measures would help foster early compliance, as would the application of earlier and more gradual financial sanctions within the macroeconomic surveillance framework. Discretion to reduce or suspend financial sanctions is undesirable as it strongly reduces effectiveness and sets the wrong incentives.

Third, more ambitious policy requirements would better match the current reality of the euro area. It makes sense for macroeconomic surveillance to have a clear focus on the euro area countries with large current account deficits, significant losses of competitiveness and high levels of public and private debt. As regards fiscal surveillance, ambitious benchmarks are needed when establishing an excessive deficit and in setting the adjustment path towards a country's medium-term budgetary objective. Such benchmarks need to be even more ambitious if a country's debt exceeds the reference value of 60% of GDP or there are fiscal sustainability risks.

Finally, the gap between the EU and national level must be closed. New procedures will not be sufficient if they are not solidly anchored at national level. Binding commitments by Member States to swiftly implement strong national budgetary frameworks are essential. Major improvements are needed regarding the quality and independence of fiscal and economic analysis and the production of fiscal statistics. All these aspects should be contemplated as mandatory features in the foreseen Directive on national fiscal frameworks.

In the ECB's view, the proposals meanwhile agreed do not go far enough. Regarding the final result, we are encouraged by the fact that the European Parliament has shown some ambition in its approach, particularly as regards greater automaticity and the broader and timelier use of sanctions. The room for halting or suspending procedures against those Member States breaking the rules must be reduced. Some other points of the Parliament's proposals also deserve a positive mention like the strengthening of the Commission's role in the procedures and an earlier and more gradual application of financial sanctions within the macroeconomic surveillance framework. It is also positive the support in the same framework for a clear distinction between Member States belonging or not to the euro area. The requirements of avoiding negative imbalances must be more demanding for members of the monetary union. This type of distinction, making full use of the Treaty's new Article 136, has to be applied in different domains, drawing the appropriate lessons of the crisis for the functioning of the monetary union.

We hope that the ongoing negotiations over the legislative package will permit the texts to be significantly improved along these lines. The ECB is encouraged that the amendments proposed by the European Parliament go in the direction of the significant strengthening of economic governance that we have called for.

However, there are some important areas in which the texts should not be weakened. In particular, softening the Stability and Growth Pact by introducing further exceptions or treating in a special way specific expenditure items, such as public investment, would create further room for unwarranted discretionary decisions. It is also of crucial importance that the economic governance reform is fully implemented as soon as possible and without any transition period.

Economic governance is not only about preventing crisis, but also about creating conditions for economic growth. Here the second strand of the economic governance package – the Euro Plus Pact – is important to give renewed impetus to structural reforms and support the ambitious targets of the Europe 2020 Strategy. On current projections, economic growth in both the EU and euro area is expected to be weak over the next decade, in a large part due to disappointing productivity growth. Faced with ongoing debt sustainability challenges and future age-related expenditures, Europe needs to do more to reverse this trend. Elevating the growth potential of the euro area through structural reforms is therefore essential.

Reinforcing economic governance and elevating economic growth cannot exclude the possibility of crises. We would all agree that, even with the best fire-proof materials and state-of-the-art alarms, it is still prudent to employ a fire service. Thus the third part of the package – the creation of the ESM – is appropriate. However, it should be underscored that the ESM is for the last resort. Its purpose is to provide temporary bridge funding to solvent but temporarily illiquid countries in financial difficulties, with the aim to create breathing space to implement a deep adjustment programme to correct imbalances and regain market access. Any financing under the ESM needs to be subject to very strong policy conditionality and, in general, should be designed such as to avoid moral hazard.

If implemented in a comprehensive and ambitious manner, the overall governance package will ensure competitiveness in the euro area, strengthen its growth potential and contribute to prevent future crises. However, within this package the first priority is prevention and correction of fiscal and macroeconomic imbalances, as this provides the pre-conditions for sustainable growth and financial stability in the euro area as a whole. The ECB hopes that policymakers seize this opportunity to place the euro area and its citizens on a prosperous and stable path.