Jürgen Stark: Hearing at the Committee on Economic and Monetary Affairs of the European Parliament

Introductory statement by Mr Jürgen Stark, Member of the Executive Board of the European Central Bank, at a hearing at the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 17 October 2011.

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Dear Madam Chair,

Dear Honourable Members,

It is a pleasure to be here today and share with you my thoughts on Economic Governance. This public hearing comes at a right time: important decisions have been taken, but major reforms are still crucially needed. I will therefore address, in turn, the three suggested issues for discussion: the implementation of the economic governance package, the longer term reforms in the economic governance framework and the question of Eurobonds.

1. Follow-up and implementation of the economic governance package

I would like to start by congratulating this committee on the passage of the six pack. The adoption of a reinforced economic governance framework shows the ability of EU decision makers to address some of the shortcomings of the existing rules which came to light during the crisis. In the current situation of market turmoil and uncertainty, it sends a signal of confidence to EU citizens and financial markets.

The final text provides for a stronger framework than initially proposed by the Commission. And this is largely thanks to Parliament. Once again this committee has used its powers to instil a more European and supranational approach in economic governance, which is incidentally very much in line with the ECB position, and I would like to thank you for that.

As you know, I have a strong attachment – to say the least – to a set of binding, quasi-automatic fiscal rules which need to underpin the sharing of a single currency. The "new" Stability and Growth Pact all SGP III – if it can be called this way – should strengthen fiscal surveillance and enforcement of fiscal discipline in euro area countries. Equally important, reinforced the statistical governance needs to be part and parcel of the framework, and important progress also in this regard is the merit of this Committee's intervention.

The new macroeconomic surveillance framework represents an important addition to the EU surveillance toolbox. The scoreboard is a key element in this [and I am aware that Parliament is very attached to its involvement in this respect]. Let me stress that the scoreboard is a means to an end – namely the detection of macroeconomic imbalances that threaten the proper functioning of monetary union. The scoreboard should remain focused and concise to draw the attention of the policy makers and the broader public to the emergence of macroeconomic imbalances at an early point in time.

Let me be frank: the governance package is an important step forward. But, and this is unfortunately a big "but", it still leaves a large room for discretion in the execution and enforcement of the surveillance procedures. The effectiveness of tools and measures that are thankfully contained in the six pack, is contingent on their implementation, not just in letter, but also in spirit.

The track record on implementing the surveillance mechanisms is less than stellar. This applies to both the Commission in presenting sufficiently strong proposals and recommendations, and the Council in exerting peer pressure. I see, therefore, high "implementation risks". The many exceptions and relevant or special factors that need to be taken into account at different stages of the procedure unfortunately reinforce these doubts. Therefore, the ECB regrets that one of the key aspects of the quantum leap in economic governance that it was advocating – greater automaticity in decision-making through the use of reverse qualified majority voting to the maximum extent possible – was only partly achieved.

I call also on this Committee to use the new tools that are at its disposal, such as the "economic dialogue", to enhance transparency and promote peer pressure and market discipline. Equally, the European Semester should be improved further, to make a useful tool of *ex ante* surveillance, and the ongoing discussion Parliament can exert pressure in this regard.

Ultimately, however, what really needs to change is the mindset of all parties involved in surveillance: they have to assume the full responsibility for the smooth functioning of EMU. This means internalising what it means to be part of monetary union, exerting strong peer pressure when necessary, and being ready to take the guidance received from their peers or the supranational institutions.

The real question is whether this more fundamental change can come about without some more fundamental shifts in competencies. As Jean Monnet, who is probably often cited in this House, said *"I have too often observed the limits of coordination. It is a method which promotes discussion, but it does not lead to a decision."* And yet the management of the euro area economy needs effective decisions, and not just inconsequential discussions. This leads me to my second point.

2. Longer term reforms in the economic governance framework

Current developments clearly show the need to reach a new quality of EMU governance by going well beyond the scope of the economic governance package. We need a genuine economic union. I trust the EP will use the review clause included in the package to enable further enhancements to the euro area economic governance that will contribute to a smoother functioning of EMU, for instance by introducing greater automaticity.

In my view, more fundamental deepening of fiscal and economic policy surveillance is necessary in the long run. This will involve a transfer of sovereignty to the European level with much stronger powers and will necessitate stricter constraints on national budget policies.

Those reforms will require a comprehensive Treaty change but above all, an adequate mechanism to ensure their democratic legitimacy through the appropriate involvement of the European Parliament and the national parliaments. Let me outline the cornerstones of such a governance reform. To ensure fiscal discipline, all planned deficits of more than 3% of GDP and those in excess of a country's medium term objective would be approved by all euro area governments. Past fiscal slippages would be automatically corrected in upcoming budgets without any room for discretion via the introduction of constitutional rules similar to the German "debt brake". All Member States would also agree to implement full automaticity regarding fines and sanctions. Moreover, countries under macroeconomic adjustment programmes in the context of ESM assistance and which fail to remain on track would be placed under financial receivership.

And finally, the institutional arrangements at both national and supranational level have to be strengthened. At the national level, independent budget offices would ensure reliable forecasts – a prerequisite for sound planning and implementation of budgets. At the euro area level this needs to be complemented by an independent entity with a clear mandate and a strong institutional framework to assess the implementation of fiscal rules, for instance some form of European Budget Office. The "EBO" could potentially form the nucleus of what could become over time and in a step wised manner a European Ministry Finance. Strong and independent institutions at euro area and national levels enhance transparency and add pressure to conduct sound policies, as well as effectively counteract possible tendencies towards a lenient implementation of fiscal rules at the level of individual member states.

3. Issuing common bonds in the euro area

Further strengthening of economic governance is a must. Do not be mistaken that there is an alternative "silver bullet" that will resolve the current crisis and prevent future ones, such as the issuing of Eurobonds. Given that one of the root causes of the current sovereign debt crisis are unsustainable fiscal policies, I want to emphasise that this calls for a clear strengthening of incentives for prudent and sustainable fiscal policies. The introduction of common bonds in the euro area would, however, clearly weaken such incentives without offering a long-term crisis resolution. Let me give you three main reasons for that:

Firstly, the fact that financial markets demand higher yields to fund governments with weak fundamentals clearly provides the right incentives for governments to ensure sustainable finances. Credible fiscal consolidation and prudent levels of government debt are in general rewarded, whereas large budget deficits and mounting government debt are penalized in the form of high credit risk premiums. Eurobonds would eliminate this incentive mechanism as governments would face the same funding costs regardless of the state of their public finances.

Secondly, the introduction of Eurobonds would also not lead to lowering the costs of the current sovereign debt crisis; it would simply redistribute them. Common euro area bonds imply a transfer from countries with solid public finances – as they will no longer benefit from lower funding costs – to those with weak ones. Unsustainable fiscal positions can no longer be punished by high credit risk premiums. This redistribution aggravates exiting moral hazard problems and undermines the long-term fiscal sustainability in the euro area. On top of this, via common bonds strong and weak countries enter into mutual obligations of very large size. This carries the risk that the sound countries will be taken hostage, e.g. to accept a gradual erosion of commonly agreed fiscal rules.

Thirdly, it is not clear at all whether an introduction of Eurobonds would really help to resolve the sovereign debt crises. Part of the government debt in the euro area would of course be converted into common euro area bonds. The remaining part will, however, still need to be funded the old-fashioned way – by means of standard sovereign bonds. Whether financial market participants would be willing to buy and hold sovereign bonds of countries with weak fundaments is by far not sure, also given the current level of risk aversion. In an extreme case, we might see a complete flight out of individual sovereign bonds towards Eurobonds, which would rather lead to a worsening of the sovereign debt crisis and not to its resolution.

Eurobonds do not offer a solution of the sovereign debt crisis and are not a viable instrument of government financing. Maybe it is worth remembering that all the proposals I have seen so far for Eurobonds are, at the heart, governance proposals. None of them can do with out massively reinforced governance or outright sovereignty transfers to the supernational level. The more appropriate way to look at Eurobonds is to *start* with governance: Only with a fundamental shift of our structures in the European Union – towards a real political union – could one conceivably create incentive and governance conditions that are commensurate with the issuance of common bonds. Before talking about Eurobonds, we should identify the necessary reforms that focus on the ultimate objective: institutional arrangements which provide credible incentives for sound fiscal and economic policies.

Dear Chair, Honourable Members, I thank you for your attention.