Jörg Asmussen: Can we restore confidence in Europe?

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the 16th Economist Roundtable with the Government of Greece, "Transforming uncertainty into stability, wisdom and growth", Athens, 2 July 2012.

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Introduction

Thank you very much for inviting me today to open this roundtable with the Government of Greece. The title of my intervention is "can we restore confidence in Europe". The simple answer is "yes", because we must, to put monetary union back on a sustainable track. The more complicated part is how to do it. In my view, it requires finding the right balance between national and European responsibilities. This has two key dimensions:

First, what can Greece itself do to restore confidence.

Second, what can the rest of the euro area do to restore confidence.

1. What Greece can do to restore confidence

Let me begin with Greece. Under the first adjustment programme it has made substantial progress in adjusting its economy. The fiscal deficit was reduced from 15.6% of GDP in 2009 to 9.1% in 2011. And very important reforms, such as the pension reform, have been implemented.

However, many other necessary reforms have not been followed through due to weak programme ownership. Moreover, policy implementation has virtually stalled over the last three months. So the first priority for the new Greek government has to be getting the programme back on track.

Some observers will ask why. They will say that the programme has failed. They will note that the Greek economy is not recovering as expected. They will point out that large parts of the Greek population reject the conditions of the programme as a "diktat" from Brussels and other capitals.

So let me make clear upfront: the programme is the best option for Greece.

The difficulties that Greece is currently experiencing do not stem from the programme. They stem from many years of unsustainable economic policies and a reluctance to implement the necessary reforms. The programme is so comprehensive because the problems in Greece are so deep-rooted. With or without the programme, any Greek government would have to pursue a similar adjustment to bring the economy back on track and restore the confidence of financial markets.

The difference is that with the programme, this adjustment is made much smoother. The fiscal measures under the programme have been designed to gradually restore the sustainability of public finances. If Greece were on its own, the adjustment would have to be much faster and more drastic, given that the sovereign has lost access to financial markets. So the programme is actually helping support the Greek people's standard of living.

The same is true of the reforms to improve competitiveness. Greece's competitiveness gap vis-à-vis its main trading partners is still at least 15%. The programme aims at closing this gap through reforms to enhance the downward flexibility of prices – in the labour market and in product and services markets. Implementing these reforms would create the basis for more export-oriented growth and job creation. Without them, the economy would adjust primarily through lower production and employment, with disastrous effects for social cohesion

Moreover, many of the reforms in the programme have been demanded for years by the Greek people themselves. There is a silent majority that wants to see a well-functioning public administration that serves citizens, enforces tax compliance, and creates the conditions for private sector growth. And had the public administration reform proceeded as programmed, it would have offset some of the contractionary effects of fiscal consolidation, as has happened in other programme countries.

Avoiding illusory alternatives

People, and especially politicians, do not like the notion that there are no alternatives. True enough, there always *are* alternatives. But they may not be realistic or acceptable ones. Some commentators would like us to believe that exit and devaluation could solve Greece's problems. I do not wish to go into details of such assessments. Let me only say that much of what is published represents dangerously short-sighted and partial analysis.

We must also be realistic about the prospects for a so-called "Marshall Plan for Greece". I fully support a re-direction of EU funds to maximise growth and competitiveness. But it takes time to programme and absorb these funds. Greece has so far absorbed only around 35% of the cohesion funds available for 2007–2013 period, a level that in fact exceeds the EU average already. So any measures we take today will not be felt in the short run.

What about relaxing the fiscal targets to support growth in the short run? Again, we need a full analysis of what this implies. Delaying adjustment is risky: it would increase the debt-to-GDP ratio in 2020 above the 120% targeted under debt exchange. This is the upper bound of what could still be considered sustainable. And it is also not free: it requires additional funding from the creditor countries, because the country still runs a primary deficit.

In some creditor countries this is challenging. It is difficult to ask voters in a country where average public sector wages are around €1000 per month, like in Estonia or Slovakia, to lend to a country where those wages are on average around €3000. The same holds true for emerging countries outside the euro area who participate in the financial assistance for Greece via the IMF. Some of those even went through very painful but ultimately successful adjustment programmes themselves; take Brazil for example.

If those countries help nonetheless, it is reasonable that, in return, they expect Greece to stick to its promises. Not because of any desire to control the Greek economy. But because solidarity has to go both ways, and a precondition for solidarity is solidity.

Getting the programme back on track

So my point is this: the new government should not lose precious time looking to avoid or loosen the programme. It should instead focus on how to maximise the effectiveness of reforms. And the key to this is much stronger programme ownership. We know from experience in Latvia, Ireland and Portugal that ownership is a crucial ingredient for success.

The new government, with a sufficient majority in parliament, has an opportunity to do this from "day one". This would give the single biggest boost to growth by removing the uncertainty that is paralysing the economy. Concretely, this means

- identifying measures to close the large fiscal gap in 2013–14;
- making up for delays in tax administration reform;
- resuming the stalled privatisation process;
- implementing the legislated labour market reforms; and
- revitalising reforms to liberalise product and services markets, starting with the full liberalisation of the closed professions and the complete implementation of the Business Friendly Greece action plan.

In other words, restoring confidence in Greece has to begin at home. And to do this effectively, authorities have to make the case more strongly for reform. They have to be clear that it is not for the Troika, or for any European leader, but for the good of Greece and its future. This is a *sine qua non* for Greece to restore fiscal sustainability and competitiveness.

2. What the rest of the euro area can do to restore confidence

Restoring confidence for the euro area is, of course, now a bigger challenge than resolving the Greek crisis. Other Member States and the European institutions also have an important role to play.

Measures in other Member States

Many euro area governments have avoided dealing with problems by hiding behind overly optimistic forecasts or unrealistic stress tests. But this is ultimately a self-defeating strategy. The problems do not go away. Instead, the market loses trust in official statements. Governments then have to take ever more drastic policy measures to win back credibility. Overall, the constant stream of missed targets and data revisions saps at euro area confidence.

For those countries receiving financial assistance, confidence can be restored by rigorously implementing their programmes. For Ireland and Portugal, this means maintaining their strong track record of implementation. For Spain, it means a convincing recapitalisation plan that removes all doubts about the solvency of its banks. The first financial review can provide a basis for this. For Cyprus, it means finally addressing its macroeconomic and financial sector vulnerabilities.

For other Member States – including France and Germany – it means learning the lessons of the crisis so far and getting ahead of the curve on fiscal and structural reforms.

Measures at the European level

But as I said in my introduction, a strategy to restore confidence must strike the right balance between national and European responsibilities, and there are also important steps to be taken at the European level.

The most pressing is addressing the institutional design of EMU. The euro area needs to send a clear message that it has understood its design flaws and has a plan to correct them. This would signal to markets that the euro area is a place they can invest. And it would underscore Member States' commitment to the euro and remove any doubts about its integrity. This alone would provide a major boost to confidence.

The report by the four Presidents in principle endorsed by the European Council last week, sets out the four core building blocks of a genuine EMU. While it is a vision for the future, each of these building blocks is designed to address the issues that are currently eroding confidence in the euro area.

For instance, the financial market union would help break the link between banks and their sovereigns and stop deposit flight. The fiscal union would prevent countries from running up excessive debt levels. Sound governance and enforceable rules can lay a path towards common debt issuance, although here the sequencing is key. The economic union would ensure that countries can adjust properly without an exchange rate. And the political union would strengthen the democratic legitimacy of EMU.

A commitment to reinforcing EMU in this way, coupled with the measures for Greece and other countries that I have described above, is the only way out of the crisis. There is no silver bullet. Those who advocate "once and for all solutions" – be that a banking licence for the ESM, a European transfer system, or the like – are contenting themselves with a superficial analysis.

The crisis can only be resolved through determined steps on a number of fronts that address its root causes.

3. Conclusion

Let me now conclude.

The title of this conference is “Transforming uncertainty into stability, wisdom and growth”. This reminds us that, in all difficult times, there are opportunities. While the situation in the euro area today is certainly challenging, we have in place a plan that is addressing long-standing weaknesses. It will ultimately lead to greater long-term stability.

But it is clear we need to improve confidence to smooth the path. This will only come through individual countries taking ownership for their situations, and the euro area as a whole taking responsibility for making EMU work. Fortunately, this is widely recognised across the union. And now, simply, we have to do it.

Thank you for your attention.