Jörg Asmussen: Building deeper economic union: what to do and what to avoid

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the Policy Briefing at the European Policy Centre, Brussels, 17 July 2012.

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Ladies and gentlemen,

The crisis has made us all a few experiences richer. The question is whether we can draw the right lessons from those experiences. After all, *"experience is the name everyone gives to their mistakes" [Oscar Wilde].* And there have been a few mistakes in the way economic policies and governance were managed inside monetary union. Policies and governance clearly needed to be strengthened. What is less clear is how best to do it. What to do and what to avoid is what I would like to discuss today. Thanks for inviting me to share my thoughts with you here at the European Policy Centre.

Without a doubt: over the past two years, much has happened in the field of economic governance. There have been a lot of proposals; the number of suggested Pacts, Compacts, Agreements and Treaties is almost inflationary. We are having a healthy debate about the future of EMU. But it is not only talk.

The report "Towards a genuine Economic and Monetary Union" presented to the June European Council by the four Presidents van Rompuy, Barroso, Juncker and Draghi sets out a shared vision for EMU over the next decade. Its content will be fleshed out over the coming months. But the devil is, of course, in the detail. Let me structure my thoughts around three main themes:

- Are we on the right path with the reforms so far?
- Are we tackling the right issues with reflections currently underway?
- What does this imply for the ECB?

1. Are we on the right path with the reforms so far?

Here in Brussels, much of the attention is naturally focused on European institutions and processes. But we should not deceive ourselves: The proper management of euro area economy needs both EU and national action.

Any governance process at European level is only as good as its record of actual application. That needs determined action by those responsible at the EU level – notably the Commission and the Council. And of course, implementation at national level.

On paper, significant progress has been achieved at EU level with the "six pack", the Fiscal Compact and the 2012 European Semester. This package of reforms has the potential to fundamentally change the way we conduct mutual surveillance. Common oversight of national economic policies is broader and more intrusive. Take the Commission's in-depth studies which revealed the existence of various degrees of imbalances in 12 countries. Or the new more automatic decision-making rules, in particular the "new comply or explain procedure" for the Commission's country-specific recommendations. These were all premieres.

This procedure puts a great responsibility on the Commission to present accurate recommendations. It also reinforces the collective responsibility of the Council.

Last but by no means least, the European Parliament introduces a degree of openness into the policy discussion. It has conducted two economic dialogues with national finance

Ministers. Our democracies require and deserve this additional layer of common public scrutiny of the economic policies.

So far, so good. But none of this is worth the great fanfare, if it remains without consequences. Member States have to address the identified problems through determined reforms.

Unfortunately, the past track record of implementation of recommendation has not been very good in this regard. Many Member States accumulated large fiscal and economic imbalances. Essential structural reforms had been postponed because of resistance of vested interests. The political costs were seen as too high, and the pressure from the EU level as too intangible. Multilateral efforts, such as the Lisbon Strategy or the Europe 2020 programme have been not effective in stimulating reforms.

Why was this? I see two main weaknesses: First, excessive politeness and the principle of non-intervention. Second, a misunderstanding of the principle of equal treatment. Let me take them in turn.

Much has been written about the "excessive politeness" and the culture of non-intervention among Ministers. And, indeed also on "preemptive obedience" on the part of the Commission when presenting its proposals and recommendations. But this lack of peer pressure among decision-makers has real costs – as we had to learn painfully during this crisis. And, it seems, the lesson still has not been learnt completely: deadlines for the correction of excessive deficits are being relaxed; the corrective tools that are available even under the new procedures, are simply not being used as the cases of Spain and Cyprus in the recently conducted macroeconomic imbalance procedure illustrate. If mutual surveillance is meant to be effective, this needs to change.

Second, differentiation among countries is still largely a no-go area in economic surveillance. And this despite the fact that the crisis has amply demonstrated the detrimental effect of excessive divergence and heterogeneity. Countries are different. The severity of imbalances varies, and so does the urgency to address those vulnerabilities. They need to be treated differently under the governance procedures. It is self-defeating to treat all countries similarly, for sake of alleged consistency, equal treatment or avoidance of stigma effects.

We all know that inappropriate policies in some euro area countries create negative externalities for the rest of the monetary union. And we cannot afford to allow some euro area countries to run policies which create a burden on others and destabilise the whole of EMU.

This begs the most important question in the debate: Are we at the end of the road with EU coordination? Do we need a qualitative leap forward? Is it time for a transfer of competencies to the European level? This leads me to my second point:

2. Are we tackling the right issues in the ongoing reflections?

The report "Towards a genuine Economic and Monetary Union" presented to the June European Council provides an answer to this question implicitly. The report recognises that we are at a crossroads and states upfront: "*national policies cannot be decided in isolation if their effects quickly propagate to the euro area as a whole [and that] there have to be ways on ensuring compliance when there are negative effects on other EMU members."* The vision for the future of EMU is built around four building blocks: integrated financial market, budgetary and economic policy frameworks as well as strengthened democratic legitimacy and accountability.

This is very much what we at the ECB had been suggesting, motivated by three reasons:

1. First, a shared vision of EMU ten years down the road will anchor expectations. The euro is here to stay. This should mitigate doubts about the survival or integrity of our

currency. It is a clear signal to the markets: underestimate the degree of political commitment to the single currency at your own risk.

2. Second, the four building blocks present a holistic view. Policy-makers have understood that the time for partial solutions, for tinkering at the edges, is over. "Muddling through", with hesitant and incomplete steps at each and every summit, will no longer do the trick. Progress needs to be achieved on all four fronts.

3. Third, it is acknowledged that euro area countries need a strong institutional framework which is commensurate with their high degree of economic and financial interdependence. The problems in Greece did not spill-over to its geographically closest EU neighbours in southeastern Europe. The contagion channel from Greece did not lead to Bulgaria or Romania but the western Mediterranean were affected. The deeper union in the euro area is necessary and is not in contradiction with the process of integration among all 27 EU Member States.

This longer-term vision has now to be turned into a fully-fledged roadmap. Matters are moving forward, in a very concrete manner, especially with regard to the creation of a financial market union with a unified supervisor, involving the ECB. This brings me to my third point:

3. What does it imply for the ECB?

The Commission will present proposals on the basis of Article 127(6) after the summer. Naturally, also the ECB Governing Council has started its own reflections. But here again, there are things to do, and things to avoid.

The ECB stands ready to play a role of supervisor for the banks of the euro area as requested. But it is of utmost importance that this framework allows the ECB to act with effectiveness, independence and without risks to its reputation.

We will need strict arrangements to safeguard the independence of the ECB's monetary policy. Moreover, with the new tasks, higher standards of democratic accountability will have to be fulfilled. We are fully aware of that and stand ready to satisfy them.

Carrying out of the new supervisory task will be challenging. But its implementation will be greatly facilitated by the fact that the ECB can count on the central banks of the Eurosystem. Most of them are already responsible for banking supervision in their own countries and have a full wealth of expertise and knowledge.

To say that the task ahead is complex is probably the understatement of the year. But we have to get it right. Even if it means that we need more time.

Let me also stress that unified supervision is only the starting point of a financial market union. The latter should also provide for common mechanisms to resolve banks and to guarantee customer deposits. This is necessary to break the vicious circle between banks and sovereigns which is at the source of the fragility of the euro area financial system.

You are surely aware of the public debate about banking union that is currently raging: we see open letters by economists for example, which can be very influential on the public at large. Although it is not always clear, if these academics are aware of the responsibility they have in public debate, because they seem to either deliberately or light-heartedly blur the facts and play with clichés. The steps we are about to take are very significant. This is why it is good to have this debate. But there should be no hesitation that – ultimately – we need to take those steps.

This leads me to my conclusion.

The core of the current debate about the future of economic union has a name: the further sharing of sovereignty. It means endowing the euro area with the power to effectively prevent and correct unsustainable policies in every euro area Member State. Concretely, this would imply that a euro area authority would have competence to limit countries' ability to issue debt and have intervention rights into national budgets, and to compel Member States to correct their policies, be that in the fiscal, structural and financial fields.

Intervention rights into national policies would be confined to cases where policies substantially deviate from agreed reform commitments and pose a serious risk to the smooth functioning of the EMU.

Those powers would have to be strongly legitimised. Whatever we do as further integrative steps, we need to strengthen democratic legitimacy. Deeper euro area integration can only be sustainable with corresponding progress on *democratic legitimacy and accountability*. Incidentally, it should not be the central bank that continuously emphasises this point.

Already now, steps could be taken to better involve the national parliaments. Domestic parliamentary debate and political decision-making needs to internalise what it means to be part of monetary union. If one looks at any of the national media, and the discourse of the domestic debates, one can see how sorely this is missing. EU recommendations are often perceived as a "Brussels diktat".

This must be overcome. One idea to ensure that would be for the Commission to present the country-specific policy recommendations to national parliaments and social partners. This would foster a political debate and national ownership. Another one would be to disentangle more clearly in communication that reform requested by Brussels are actually improving social justice, for example, more efficient tax system, or the end to rent-seeking by vested interests. Those policy prescriptions are not only about austerity, which gives them a negative connotation. When governments implement the Commission recommendations they do this not only to "comply with Brussels" but for the good of their own countries.

Ladies and Gentlemen,

Thank you very much for your attention. I look forward to a stimulating debate.