Jörg Asmussen: Eurozone cross-fire: the way out of economic recession – assessment of a realist and a response to idealists and cynics

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the Bank of America/Merill Lynch Investor conference, Washington DC, 20 April 2013.

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Sylvie,

Laurence,

Ladies and gentlemen,

Thank you very much for inviting me to speak at today's investor conference.

Introduction

The Eurozone can be difficult to understand. Especially when seen from this side of the Atlantic, the complexities of the macroeconomic and financial situation and of the political dynamics in Europe can be baffling.

To cut through the complexity and amidst fragile confidence and the "noise" of crisis management simple answers and "once-and-for-all solutions" seem attractive.

Unfortunately, this kind of answer is an illusion. Because the crisis in the euro area is multi-faceted.

It is, at once, a crisis of public and private debt, a crisis of competitiveness and growth, and a crisis of trust; in institutions, in politics and in decision-making. Tackling the crisis successfully and comprehensively will require solutions for all of those.

When I read the commentary, especially over here, on the crisis in Europe, I often see two stereotypical responses, those from what I would call "idealists" and those from "cynics".

First, the idealists: they say the euro area is too heterogeneous and divergent. They say the euro area must integrate completely, or risk breaking up. As a solution to resolve the crisis, they allege that only a move to a "United States of Europe" will do, with joint issuance of debt, a transfer mechanism, and "the works".

Then there are the "cynics". They accuse Europeans of practising "medieval medicine" – bleeding the patients in a bid to cure them. They contend the "bitter pill of austerity" will kill the patient, and the people will not take it any longer. They say that overcoming the crisis will need more time, less austerity; more public money, less reform. And they often call on the ECB to do more.

I believe none of these caricatures reflect the reality of the response in Europe.

The US journalist Sydney J. Harris once wrote *"an idealist believes the short run doesn't count. A cynic believes the long run doesn't matter. A realist believes that what is done or left undone in the short run determines the long run".*

I believe it is imperative to convey, not only the short-term outlook for the euro area, but also to dispel certain generalisations regarding the ongoing adjustment in Europe and the long-run vision for Economic and Monetary Union.

In this context, allow me to briefly outline what I would consider, a "realist's assessment".

The on-going adjustment in EMU

The adjustment in the Eurozone is underway. There is also no doubt it is painful, especially for the people in some countries of the periphery.

However, let me give you some evidence of what has actually been achieved.

In programme countries, we have seen a strong improvement of structural primary balances since 2009. In Greece, for example, this is estimated to have improved by more than 14 percentage points of GDP between 2009 and 2012.

To put this into context, in this country, the "sequester" calls for cuts of 1.2 trillion dollars over ten years. The equivalent of what Greece has done would have meant for the US an adjustment of 1.6 trillion dollars over three years.

In EMU, this adjustment is being undertaken within a reinforced fiscal framework – a new set of rules – which strengthens the ability to prevent and correct the accumulation of excessive deficits. Furthermore, a new framework for the surveillance of macroeconomic imbalances has been established.

And also on this front, a very large correction of external imbalances is visible.

In Greece, Portugal and Ireland, the current account balances have each improved by more than 7 percentage points of GDP between 2008 and 2012.

It is true that much of the adjustment has been driven by a contraction in domestic demand. However, in Ireland and Portugal export performance has also been strong, because programme countries are now reaping the benefits from their significant improvement in cost competitiveness.

This is evident from the significant reduction in unit labour costs. For Greece, Ireland and Portugal we see about a 10 percentage point improvement relative to the euro area average. The adjustment in Ireland has been spectacular, and translates into about an 18 percentage point improvement between 2008 and 2012. This means that the past excesses have by and large been undone.

Government bond spreads now fluctuate at much lower levels compared with the peak of the crisis. This will eventually also facilitate the return to bond market access in Ireland and Portugal.

This was also assisted by the announcement of Outright Monetary Transactions (OMTs), which contributed significantly to removing redenomination risk in the euro area.

Some may ask: why can't the ECB do more? Why can't the ECB be more like the Federal Reserve… or the Bank of Japan, for that matter? Why can't the ECB engage in quantitative easing or have an employment target?

Those who make these calls must first consider the very different institutional set-up in which we operate. The ECB can only take measures that are consistent with its mandate. Our primary objective is price stability, we do not have the wide mandate which for example the Federal Reserve has.

Second, the structure of the financial market in Europe is very different. In the US, for example, a large share of financial intermediation takes place through capital markets. This provides a broad and deep pool of assets to purchase. However, the structure of the euro area economy is largely bank based. Thus our monetary policy strategy must be tailored accordingly, mainly through the provision of credit to the banking system.

Third, the specific economic challenges we face differ from those in other parts of the world.

In this day and age, where many look to central banks as the ultimate problem-solvers of many economic ills, let me also be clear that there are clear limits of what we, the ECB, can

– and cannot – do. We cannot repair unsound budgets. We cannot clean up struggling banks. We cannot solve deep-rooted problems in the structure of Europe's economies.

Conclusion

I want to conclude with some clear messages.

To the cynics, my message is: we will not solve a debt crisis with more debt. Moreover, simply giving more time will not resolve the underlying structural problems.

Member States who are implementing the necessary adjustments have begun to reap the benefits. Relaxing now would mean endangering the hard-won gains of past efforts. The foundations of future growth are fiscal sustainability coupled with structural reforms.

In a way, we have a "debt ceiling" in Europe too. It is not set by an Act of Congress, but by the markets. Investors have clearly shown they are not willing to further finance Member States with such high levels of debt, at a reasonable price. Therefore the adjustment must continue.

To the idealists, my message is that the EU is, at this stage, an emerging union, built on the basis of Member States who agree – or disagree – to pool sovereignty. Moving to a deeper economic integration, which is commensurate with a monetary union, is necessarily a process. But it is underway.

Such a deeper economic union will not be the archetypical Union, which some of you may have in mind. It is worth remembering that the Union on this side of the Atlantic was built over almost 250 years, and it took 150 years to establish a central bank. The EU is 60 years old, and the euro, only 13.

Over recent years, the euro area has taken big steps forward to reinforce its framework for fiscal and macroeconomic governance. Member States continue to display unprecedented solidarity towards each other, providing financing for programmes of economic adjustment along with the IMF. The establishment of a banking union, including a single supervisory mechanism involving the ECB and, the forthcoming proposal for a single resolution mechanism, are further examples of deeper integration.

Earlier this year, the ECONOMIST reviewed last year's doomsday predictions about the imminent demise of the Eurozone. It noted correctly that *"the pessimists did not overestimate the euro's problems, so much as underestimate the political will to do enough to stop a euro break-up."*

Going forward, it would be a grave error to underestimate the continuing political commitment to making the single currency a success. But it also remains true what was once said, namely that EU institution-building is like the love-life of the elephant: Everything goes on at a very high level, a lot of dust gets raised – and you have to wait for months and years for results.

Thank you.