# José Manuel González-Páramo: Completing the euro project – the day after tomorrow

Speech by Mr José Manuel González-Páramo, Member of the Executive Board of the European Central Bank, at the Official Monetary and Financial Institutions Forum (OMFIF) Golden Series on World Money, London, 18 May 2012.

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## 1. Introduction

Ladies and Gentlemen,

Thank you very much for the invitation to speak today to the distinguished audience at OMFIF's headquarters in London. Few other places in the world concentrate comparable expertise in finance and similar experience with financial crisis.

I would like to reflect today on the current challenges in the euro area and, in particular, those relating to the institutional set up of the euro.

To be meaningful, any reflection on the future of the euro should start with a reference to the past. In the early months of 2009, Europe's economy was already in crisis. While we were passing through a recession, coupled with the aftershocks from the collapse of Lehman Brothers, the situation was qualitatively very different from today. In 2009 the credit risk perception of financial institutions and the confidence of investors and consumers had clearly deteriorated. To address this situation, the European Union (EU) deployed three lines of defence: an aggressive easing of monetary conditions, strongly expansionary coordinated fiscal policies and also coordinated measures to support the financial system. The role of sovereign credit was not in question, nor the role of the euro. No one spoke of a "sovereign debt crisis", much less of a "euro crisis".

Today things are different. Since the beginning of the Greek crisis and the debate on private sector involvement in the debt restructuring, the perception of sovereign credit risk in Europe has grown to an unforeseen extent. The lines of defence of fiscal policy and financial system support have been overwhelmed by the markets in many cases. And the tensions in the markets have been contained in the first instance by unconventional monetary policy measures, whose aim has been to restore the transmission channels and strengthen credit support. The room for manoeuvre of conventional economic policies has diminished significantly. That's the bad news. And the good? There are several important pieces of good news. First, the economic and political fundamentals of the euro do not allow us to conclude that our single currency is in crisis. Second, the origin of the institutional weakness of the euro has been clearly identified. And third, since 2009, and particularly since last autumn, European governments have acted individually and collectively to establish or strengthen the pillars of a stable and durable euro. Today, as has so often been the case for more than half a century, we see that Europe's problems have only one solution: more Europe.

## 2. A crisis of the euro?

The issue of the so-called euro crisis is one of the most controversial, and at the same time sterile, to occupy economists, politicians and citizens in the last two years. "The euro will not work", some press and intelligentsia told us in the early 1990s. "We already warned you: the euro is in crisis", they now tell us, not without some Schadenfreude. So much so that prominent eurosceptics race to set up prizes to be awarded to the best proposals responding to questions of the type: How can countries ensure their future prosperity once they decide to leave the euro? The underlying assumptions are obviously, that abandoning the euro is something natural and preferable to staying in the bloc, and that there is a better alternative

to keeping the euro. As so often happens, ideologically loaded arguments have actually had the opposite effect to that intended. So we see now the emergence of a common ground, acceptable to media that was never particularly warm to the euro. As the WSJ puts it: "The euro's problems are undeniable. But trying to remedy them seems preferable to risking chaos in the world's second largest economy (...). The best interests of the euro area lie (...) in greater economic and political integration". I would subscribe to this assertion.

On a more substantive note, a project which has yielded good economic results and which maintains the political support that brought it to life cannot be in an existential crisis. Let's take a quick look at the numbers. Since 1999, average inflation has been close to 2% in the entire euro area. This has been, and remains, the ECB's commitment to its mandate. The ECB has also made a major contribution to financial stability and, in this way, to creating trust, especially during the crisis. Today few would argue that without the measures taken by the ECB during these five years, we would be talking about a 1930s-style economic depression.

So much for monetary stability, but what can be said about growth, employment and other real variables? The conclusions to be drawn are straightforward, but perhaps surprising for eurosceptics. From 1999 until the outbreak of the crisis, the euro area created 15 million jobs, twice the figure in the US, and cut its unemployment level by two points, to 7.6%. Per capita income increased almost 14% in just one decade, and productivity by 7%. Our savings rate is consistently more than double that of the US or Britain, our contribution to global imbalances nil, with our external accounts being almost in balance, and our public finances, despite the difficulties, show a deficit standing at around 4% of GDP in 2011, less than half that of the US.

Not surprisingly, seven out of ten residents of the euro area with an opinion, according to the latest Eurobarometer, think that the euro has been a good thing. And the euro is also viewed worldwide as the most successful symbol of Europe's integration, which started half a century ago.

So, we do not have to resort to Mark Twain to conclude that the rumours about the death of the euro may be somewhat exaggerated. However, it is undeniable, and this is the great paradox, that Europe now finds itself in the focus of global financial stress due to the sovereign debt crisis. But this is not a euro crisis. It cannot be when the reaction of governments to the crisis has been to consistently renew their commitment to integration. It is a crisis of market confidence in the willingness and ability of some countries to comply with the demands of the euro – and a crisis of the design of the institutional foundations of the single currency. Let me briefly explain the reasons for this institutional fragility.

## 3. The institutional weakness of the euro

From its very conception, like all the big steps in the history of European integration, the euro has been an ambitious and unique project. It combined a centralised monetary policy with decentralised but coordinated economic policies. Paraphrasing Tommaso Padoa-Schioppa, we decided to give ourselves a currency that doesn't belong to any single nation-state. The advent of the euro was only an episode – surely the most significant in history – of the construction of a post-Westphalian order of shared sovereignties.

One of the key lessons that we have learned from the crisis is that the design of the euro was incomplete. Indeed, the euro area lacks certain institutional elements which we associate with federations and which act as shock-absorbers, countering the negative effects of shocks and imbalances. The logical corollary is that we need to compensate for these "missing institutions" by establishing a much stronger financial and economic union.

One area in which the absence of stabilising institutions has been keenly felt is that of current account imbalances within the euro area. These imbalances existed before the crisis for many years, although many said they were irrelevant in a monetary union. But now it is clear

that current account imbalances, although not one of the essential causes of the crisis, are not benign and are an indicator of vulnerability that can be transmitted to the euro area as a whole.

On the financial side of the current account the persistent imbalances between the member countries of the euro area indicate that some public sectors or private sectors, or both, are living beyond their means year after year. And if, as has been the case in some countries, these imbalances are also linked to a strong build-up of foreign liabilities by a domestic banking system that has taken excessive risk positions, we find ourselves in a situation in which twin crises can develop – a crisis affecting both the sovereign and the banks, with negative feedback loops between them – as we have recently witnessed. Because, in effect, private debts can be rapidly converted into public liabilities as soon as governments are forced to recapitalise banks or guarantee their funding, which can in turn lead to a sovereign debt crisis. At the same time, high public debt levels can impinge upon the health of the domestic banking sectors, given the exposure of euro area banks to paper issued by their governments and the link that the markets may make between the cost of funding banks and the cost of funding their respective sovereign.

In principle, these vicious circles involving both banks and governments can be better mitigated in a framework of federal political institutions. For example, if a particular state of the US were to experience a significant build-up of private debt that would threaten their local banks, the responsibility for its recapitalisation and deposit insurance would be borne by the federal government, through institutions like the Treasury Department and the Federal Deposit Insurance Corporation. This means that a US state cannot get into financial difficulties because of a mismatch between the size of its banking sector and the size of its local economy, while in the euro area this can occur. The absence of these kind of federal institutions in Europe is a source of vulnerability.

In the real component of the current account, persistent trade imbalances within the euro area also reflect sustained losses of competitiveness in the deficit countries. The problem can be temporarily masked in a context in which economic growth is driven by strong credit and consumption dynamics, as was the case in some Member States before 2008. But when financial flows that feed this process suddenly stop and are reversed, i.e. when foreign lenders are no longer willing to fund an additional build-up of foreign debt, cumulative competitiveness losses come to the fore. And this can lead to particular regions of the euro area suffering from extended periods of low growth and high unemployment.

And again, these negative effects could be eased by the stabilising institutions of a political federation. Federations tend to have a certain cultural and linguistic homogeneity which facilitate labour mobility, offering an adjustment channel. At the same time, federations have a relatively large common budget which offers a natural shock-absorbing capacity, since programmes like unemployment insurance, social security contributions as well as taxes redistribute income between the richest or most stable regions and those most affected by economic disruptions.

## 4. The institutional architecture of a durable and stable euro

None of this was unknown before the decision to create the euro. However, the founding fathers believed that the commitment of governments to maintain sound public finances and to complement the internal market with structural reforms in combination with market-discipline could make up for the absence of federal institutions in the financial and budgetary spheres. Based on these elements and on a common monetary policy aimed at price stability, the euro should provide its members with non-inflationary growth and high employment. And indeed, things seem to have developed along these lines during the first decade of the new currency.

The current sovereign debt crisis is clearly showing us that, even though the monetary component of the euro, which falls under the responsibility of the ECB and the Eurosystem, has worked better than those legacy currencies of the euro which were considered to be the most solid, the adaptation of fiscal policies and structural reforms to the new demands of the single currency has been insufficient. Some governments did not internalise the requirements of the euro when designing their economic policy, and acted as if the loss of competitiveness and the fiscal vulnerabilities could still be wiped away through the traditional resort to inflation and devaluation. But inflation and devaluation are the vessels that we consciously decided to burn upon the creation of the euro.

And neither has the framework for coordinating fiscal policies worked well, not to mention the complete lack of coordination of macroeconomic policies, influencing competitiveness. The Greek crisis and its contagion to other vulnerable countries have been the irrefutable proof: no matter how small the country, its competitiveness problems and imbalances can have a systemic impact. In this context, the absence of federal-type shock absorbers has resulted in a loss of market confidence in sovereign paper as a risk-free asset, and even in the fungibility of bank money, which has experienced episodes of flight to banking systems located in countries perceived to be stable. Gross political mistakes, such as the "Deauville doctrine" on private sector involvement in debt restructuring or the public debate about a country possibly abandoning the euro, have worsened the situation. All too frequently, the common monetary policy has been left to play its role in resounding solitude.

It is clear today that the road we must travel to support the stability and to reaffirm the irreversibility of the euro cannot get round building the institutions of a political federation overnight. The euro area needs to follow a different path to ensure a stable functioning of monetary union to compensate for the absence of these institutions, without excluding the possibility that the process of European integration may also lead to federalisation in the medium to long term. This approach to the completion of the euro project should focus on four key pillars of stability: economic governance, crisis management, financial regulation and supervision, and monetary policy.

### *4.1 Economic governance*

The first pillar should be to fundamentally strengthen *governance procedures* to prevent and avoid the emergence of imbalances. With fewer institutions capable of providing stability and mitigating crises when they arise, we must be more effective in preventing the emergence of serious imbalances. This process has led us to strengthen fiscal policy rules and to create mechanisms for monitoring and correcting macroeconomic imbalances and competitiveness ("six pack" legislation, the Treaty on Stability, Coordination and Governance and "the fiscal compact".)

On the fiscal side, the reform of the Stability and Growth Pact (SGP) and the new "fiscal compact" are specifically designed to detect and correct the fiscal imbalances at an early stage. One key aspect of the reform of the Pact has been the strengthening of its "preventive arm". For example, sanctions will now be possible not only in cases of non-compliance with the 3% limit, but also deviations relating to the medium-term budgetary targets, disciplinary procedures will follow reverse qualified majority rule, and the debt criterion will play a more active role. The "fiscal compact" strengthens this focus on prevention through a new "first line of defence": the introduction of balanced budget rules in the constitutions of member states. These rules have the merit of shifting to the national level the main responsibility for compliance, rather than calling it to account in Brussels. In fact, if the rule is applied strictly, the "fiscal compact" will correct imbalances before the European Union procedures even need to be activated.

Another lesson from the experience of the last decade is that the soundness of public finances is not the only relevant factor to be monitored. Macroeconomic imbalances and competitiveness losses may also lead to severe disturbances with systemic consequences.

The new "macroeconomic imbalances procedure" (MIP) allows early monitoring of variables such as competitiveness trends, private credit flows, house prices, the real effective exchange rate or unit labour costs. If the procedure identifies the existence of imbalances, a system of alerts, recommendations and, if necessary, penalties can be triggered. Under the MIP, which is designed in parallel and complements the Stability and Growth Pact, the "exuberance" of credit and the cumulative losses of competitiveness that we observed during the first decade of the euro would have flashed "red lights" much earlier. This procedure has been criticised by some as being asymmetric in relation to the so-called "super-competitive countries". Admittedly, the vulnerabilities created by excessively large current account deficits are greater than those associated with surpluses, and therefore require more urgent remedies. Nonetheless, structural factors underlying high and sustained current account surpluses are also partly addressed in the procedure, although not to the same extent as in the case of the countries in deficit. For example, parallel to the MIP, the Commission intends to conduct further analyses on the determinants and possible implications for economic policy arising from the existence of high and sustained current account surpluses including in this examination commercial and financial links between surplus countries and deficit countries. The Commission should also examine alternative ways to rebalance the current account imbalances, in particular within the euro area, also taking into account the global context. In this regard, we must remember that a recurrent theme in the response to the crisis has been the renewed emphasis on structural reforms, and this is reflected in the Euro Plus Pact and Europe 2020 Strategy, which apply to all participating countries, including those in which an excessive level of domestic savings derives from structural rigidities.

Since 2011 the strengthening of the coordination of fiscal and macroeconomic policies relies also on the so-called European Semester, a procedure under which the Union will discuss the guidelines and reform priorities during the first half of the year, so that the debate in national parliaments and the elaboration of national stability or convergence programmes for each country can rely on these orientations.

### *4.2 Management and resolution of crises*

Despite all this progress, which undoubtedly represents a qualitative leap in the governance of the euro, it would be naive to believe that crises will be relegated to history only because we will always manage to avert them at an early stage. The second pillar on which a more stable monetary union should be based, in the absence of conventional federal institutions, is the strengthening of the *crisis management and resolution mechanisms*. Having witnessed how imbalances in a euro area country, no matter how small, can become systemic and create tax liabilities for taxpayers in other countries, European Union institutions, governments and national parliaments are now playing a much more prominent role in demanding and monitoring economic reforms.

This change is visible in the much more active role of the heads of state or government of the euro area countries – now institutionalised in the so-called "euro summits". It is also evident in the more intense scrutiny to which national parliaments subject the economic policies of other Member States. For example, before approving assistance programmes, a number of national parliaments now require compliance reports prepared by the European Union and the International Monetary Fund, and an analysis of debt sustainability. This new role for national parliaments serves to highlight the recent remark by Herman Van Rompuy that national parliaments are increasingly European institutions.

Until May 2010, the euro area lacked a financial stabilisation mechanism. At that point in time governments decided to close this institutional gap by creating the European Financial Stability Fund (EFSF). This temporary fund can provide, under strict conditionality and based on guarantees by Member States, loans to countries in distress, and it can intervene in the primary and secondary debt markets, offer programmes on a precautionary basis and fund bank recapitalisation through loans to governments. From July 2012 the European Stability Mechanism (ESM) will start operations; this is a permanent instrument with capital of

€700 billion. In March this year the Eurogroup agreed that as from July both funds will coexist for about a year, with a joint lending capacity of €700 billion. In mid-2013 the ESM will be the main instrument for financing new programmes. These funds may be supplemented by those contributed by the International Monetary Fund, to which euro area countries have pledged an additional €150 billion. These funds form part of the over $430 billion in additional resources that countries committed to the IMF at the April 2012 G20 meetings.

The Commission is also gaining a much more prominent role in crisis management through the new "two pack" legislation which is set to be approved this summer. The current proposals would allow the Commission to place a Member State under "enhanced surveillance" when it is experiencing financial difficulties or is simply threatened by them, whether financial assistance has been requested or not. This new situation would entail implicit stress tests for the banking system via the European Banking Authority (EBA), close monitoring of macroeconomic imbalances and regular missions by the Commission, in cooperation with the ECB. Likewise, the Commission is empowered to reject and return to government budgetary drafts that do not fulfil the Stability and Growth Pact before they have been adopted by the national authorities.

From the description of these two pillars – prevention and correction of imbalances, and crisis management – it must be concluded that the euro area is responding to the crisis by creating a much more consistent model of economic governance. In many of its facets, this *sui generis* response is different from the standard template of political federations, in some cases going further in terms of the powers exercised at the "central level". For example, the "two-pack" legislation gives the Commission the power to demand reforms that the US federal government could not impose upon a US state. For instance, the US federal government could not fine a state if, say, its tax code was regarded as favouring a housing bubble in the state. This possibility of sanctions is not ruled out under the MIP.

### *4.3 Financial regulation and supervision*

The new governance model still needs further refinement, particularly in the financial dimension. No economic and monetary union can function properly without a large degree of "financial union". This should be the third pillar of the euro that is coming. During the first years of the single currency, financial integration made impressive progress in some markets, such as the bond markets, stock markets and money markets, but advanced very modestly in other areas, particularly in the case of the banking system. In retrospect, this may seem surprising, since four-fifths of private sector financing comes from the banks. The diversity of supervisory regulations and practices have made regulatory arbitrage possible and, in some cases, it has even led to the emergence of protectionist barriers across different domestic financial markets.

A positive initial response to the financial crisis has been the active role played by the Commission in seeking to ensure that public support to financial institutions becomes subject to conditions that limit the distortions to fair competition within the single market. Another important milestone leading to a pan-European approach to supervision has been the creation of the European Systemic Risk Board (ESRB) to strengthen macroprudential supervision within the EU as a whole, which has filled one of the most acutely felt institutional gaps during the crisis.

Until recently, however, under the umbrella of the same legislation, we have witnessed regulatory competition to attract business, the oversight of cross-border groups has suffered from a lack of coordination and the compliance process has been fragmented along national borders. For this reason, it is difficult to overstate the importance of the commitment of EU institutions to a "single rulebook". According to the logic of this approach, which pursues a growing harmonisation of supervisory standards, once the European Banking Authority (EBA) or the other European supervisory authorities (ESMA and EIOPA) have developed

technical standards, once adopted by the Commission, these standards will become legislation directly applicable to entities, with no need for national transposition.

The potential of the "single rulebook" is enormous, although resistance to the concept of maximum harmonisation remains significant. In the area of crisis prevention, the difficult discussions surrounding the definition of capital, or the application of new liquidity requirements, among other Basel III proposals, will have to be followed closely.

But perhaps the most demanding challenges are in the field of crisis management and the resolution of financial institutions that are both systemically important and which have significant cross-border operations. A legislative proposal from the Commission is expected in the coming months, detailing common tools for monitoring and resolution as well as principles of cooperation and mediation applying to cross-border institutions, and the role of the EBA in these processes. If we add to these important developments the possibility of recapitalising banks through the ESM in the case of countries not subject to a programme, we could speak of the first significant steps towards a euro area regime. In the medium term, in my opinion, this should be followed by the creation of a pan-European resolution fund and a pan-European resolution authority. This design would maximise the benefits of the financial union, since only a pan-European orientation would minimise the involvement of taxpayers, help diversify risks, and effectively break the pernicious link between risks to the national banking sector and to the respective sovereign. Awareness about these advantages should help ease technical and political resistance to these initiatives.

### *4.4 Monetary policy*

I must mention, finally, the fourth pillar: monetary policy. It has been said repeatedly, perhaps with exaggeration, that when the history of the crisis which started five years ago is written, the ECB and the Eurosystem will emerge as the saviours of the euro. However, it will be no exaggeration to point to the ECB as the first line of defence, as early as August 2007, and possible the most prominent one once the margins for fiscal policy and financial sector guarantees had been squeezed in the face of market pressures.

As the only European institution with executive powers and a federal mandate and functioning, the temptation is to conclude that there is nothing new to invent in this domain. "If it ain't broke, don't fix it". I think this is a feeling that many share. Be it as it may, what is important is to realise that, after just over a decade, the ECB has become a model of credibility at the international level. First, because it has fulfilled its mandate of price stability in a period marked by crisis and episodes of sharp rises in the prices of raw materials and energy. Second, because through the use of its unconventional measures – deployed more quickly and with more flexibility than any other central bank – the ECB has, to a considerable extent, been able to repair the transmission mechanism of monetary policy and to provide enhanced credit support without which a credit crunch would have taken place in the euro area.

And third, because its contribution to financial stability in the euro area has increasingly become clear, without prejudice to the ECB's primary mandate of price stability. The ECB's contribution to financial stability has been both an indirect consequence of its monetary policy, as both price stability and non-standard measures have promoted financial stability, as well as a direct result of the role the Eurosystem has come to play in the context of the newly created ESRB. It should be emphasized, however, that even when price stability is ensured, the ECB should only *contribute* to the stable functioning of the financial system, because the primary responsibility for guaranteeing financial stability lies with regulators, supervisors and governments.

## 5. The day after tomorrow: politics and markets

Let me conclude with some thoughts about the future. What does the day after tomorrow hold in store for us? This is an issue that cannot be answered by abstracting from the political substrate of the euro, or the complex interactions between politics and markets. And ignorance of these facts are a fundamental error shared by both fans and critics of the euro. From the fans we often hear this kind of advice: "End the sovereign debt crisis immediately? Easy! Let's create a federal budget, eurobonds, a treasury or ministry of finance of the euro and common financial supervision". Naturally, these proposals are immediately rejected by many sectors of public opinion, and are not welcomed by the markets. From the critics we receive disinterested advice on how to undo the euro which not only overlooks the political vision that inspired it, but also the impossibility of avoiding a debacle of incalculable dimensions if the fungibility of bank money is threatened in a part of the euro area, no matter how small.

Two specific arguments based on an acknowledgement of the existing interaction between politics and markets lead to the conclusion that deeper integration and governance of the euro area is needed. First, much of the institutional design flaws of the euro stem from a naive faith of politicians two decades ago in the disciplining ability of the market. It was thought that since there was no mechanism to allow transfers to rescue troubled countries, markets would discriminate against those with less prudent fiscal policies, with larger financial imbalances and with worse indicators of competitiveness. But the markets never played this role, not even when the only framework worth mentioning in the field of governance, the SGP, was diluted in the face of the rebellion of major member countries.

The mistake was to believe that the second-most important currency area in the world could delegate its governance to rating agencies and markets which are always prone to overreaction and which are generally pro-cyclical. The absence of self-governance has resulted in governments being forced to hastily approve reforms in dramatic meetings, which has made it difficult to explain the reforms to the people and to achieve a consensus – all of which has not served to contain the contagion. That is why, with the hopes that were once placed on market discipline now frustrated, politicians have realised that they have to create a largely non-existent system of governance. This discussion raises a question. If so much has been achieved since 2009, why haven't the European authorities been more effective in ending the debt crisis, the attacks by the markets and the contagion? In my opinion, the answer lies in the functioning of the political institutions at the present stage of integration. All major decisions are made by 17 sovereign democracies. Unlike a unitary state, the euro area has 17 heads of state or government, 17 ministers of economy and countless national parliamentarians. Not surprisingly, in complex matters such as European ones, their messages to the media often diverge. As we have seen many times, these differences can lead to echoes and adverse interactions between politics and markets that ultimately end up undermining the effectiveness of the decisions taken, however important they may be.

To some extent, this is a procedural problem: our institutions are not sufficiently effective to ensure that political leaders speak with one voice. But at a deeper level, it is a problem that stems from fundamental differences in the expectations and perceptions of citizens and markets. Markets expect messages of confidence, immediacy, and an unlimited capacity of governments to act. The residents of each country, meanwhile, want to know the limits to tax obligations for which they may be liable, they want to be sure that the decisions are fair and equitable, and they want to feel confident that mistakes will not be repeated.

A classic example of this divergence has been the debate over private sector involvement in debt restructuring. For a domestic audience, banks must accept the consequences of past mistakes in lending to countries. But from the perspective of financial markets, such communication is disastrous, because it indicates to investors that some sovereign assets previously considered risk- free have become risky, i.e. the euro area is a market in which sovereign investments are not guaranteed. And as markets are moved by expectations, they

resolve to unwind their investments today, or take short positions in order to do it tomorrow. This process immediately weakens the achievements made on the institutional front. A second example comes from the practical implementation of policy decisions taken in response to the crisis. Markets expect decisions that have an immediate effect, decisions that are bold, front-loaded and far-reaching. They become exasperated by the fact that political agreements can take months to become operational, as was the case with the European stability funds or mechanisms. However, the decisions must be explained, the approval procedures followed and sometimes political compromises have to be negotiated, and all within a system of 17 sovereign democracies. Thus, once the decisions have already been implemented, we find that expectations have changed and that these decisions are now taken for granted.

This complex relationship between governments and markets is another reason why it is essential that we achieve a closer and deeper economic and financial union in order to ensure a stable future for the euro. The logic of the original design of EMU, a single or federal monetary policy, coexisting with decentralised economic policies, was linked to the principles of subsidiarity and democratic accountability. This was consistent with the prevailing setting for two decades. But these same principles today involve more Europe. Because the principle of subsidiarity assigns to the European authority tasks that cannot be effectively carried out at the national level. Can anyone argue, after the intense experience of the crisis, that a European level of government is not the most effective way to conduct directly, or at least coordinate, certain economic and financial policies?

Democratic accountability is a principle under which citizens must be able to demand accountability from politicians about the decisions taken. But if we need a stronger European authority, the principle requires a profound improvement of democracy at the European level. And any thoughts on what this entails should start by recognising that membership of the euro leads to a significant degree of political union. We have found that in order avoid crises all member countries should take responsibility for monitoring and for exercising peer pressure in relation to the economic policies of the rest. And we have also seen that in order to correct the effects of the crisis in the euro area we need decisions to be taken collectively and to consider the euro area as a whole rather than to be dominated by specific national interests.

The need for institutionalized collective decision-making procedures is what defines a political union. This need has been felt *de facto* by the members of the euro area since the beginning of the crisis. Its *de jure* recognition has been somewhat slower but decisive. Thus, the Treaty of Stability, Coordination and Governance will enter into force on 1 January 2013 if 12 Member States ratify it. This Treaty will in effect put a end to the right of any single country or small group of countries to exercise a veto, The Eurogroup represents stable enhanced cooperation. Unlike the EFSF, the ESM is an institution under the Treaty. The Community method is once again gaining ground after the blossoming of intergovernmental agreements. The rules for fiscal and macroeconomic governance have been created or reinforced with strict criteria. Despite some initial delays in the financial front, things are also starting to move forward in this front, with the creation of the European Supervisory Authorities, the "single rulebook" and the future directive on management and crisis resolution. These are clear illustrations of a course that, while far from implying the level of federalisation that we have in monetary policy, represents significant progress towards a political union.

And when these institutions and procedures become a reality and show that they can work, debates such as those we should have about the federalisation of banking supervision and deposit insurance, or the federalisation of fiscal policy will make sense. But this will only happen the day after tomorrow. For the immediate challenges are to put our houses in order, regain competitiveness and clean up our balance sheets and, perhaps more importantly, reaching an understanding that sharing sovereignty in the euro area is not tantamount to

losing sovereignty. Rather, sharing sovereignty is the only way to secure a future of stability and progress.

Thank you very much for your attention.