Jörg Asmussen: The Eurozone and Japan – the way forward

Intervention by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the 2012 Annual Meetings of the IMF and World Bank Group, Tokyo, 12 October 2012.

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Ladies and gentleman,

It is a pleasure to take part in this discussion today, and in particular to join the company of such a distinguished panel of European and Japanese colleagues.

With events moving so fast in the euro area – and in ways that are often confusing for outsiders – getting out and speaking to investors around the world is more necessary than ever. So let me also extend my thanks to Juergen Fitschen and Deutsche Bank for organising this very useful event.

As time is short, I would like to begin my intervention by jumping straight into the three questions that are the focus of this panel today.

- How to return to sustainable debt levels in the euro area?
- How to deal with intra-euro area competitiveness imbalances?
- Where does the euro area go from here?

How to return to sustainable debt levels in the euro area?

Turning to the first question: how to return to sustainable debt levels in the euro area?

Debt sustainability in the euro area is being questioned for two reasons.

The first reason is that some investors are afraid of destructive scenarios that could lead to default or, in the extreme, exit from the euro. As a result, they are forcing some countries to pay risk premia that are not fully justified by underlying fundamentals, making those destructive scenarios self-fulfilling.

But this aspect of debt sustainability can be addressed by simply changing perceptions. Here, the ECB's recent announcement of Outright Monetary Transactions should play a supportive role. It provides a credible backstop for tail risks and confirms that the euro is irreversible.

The second reason debt sustainability is being questioned is that certain euro area countries have debt levels that are too high, or on a sharply rising trajectory. This is more complex to deal with. Inflating away the debt burden is not an option in the euro area. So Member States have to take policy actions to redress public finances. But the evidence suggests it can be done.

To stabilise debt levels, the euro area already has a benchmark a new debt reduction rule agreed as part of reforms to fiscal governance. Observing it will be difficult for some countries. But they have made similar adjustments in the past. Many ran fiscal surpluses for years before entry into the euro.

To support this process, it is urgent to improve euro area growth rates, which are projected to remain low for a number of years. This can be done by unlocking the many rigidities that still exist in euro area product and labour markets.

This process of debt stabilisation is already well underway. The IMF projects that the euro area will be almost in primary balance this year, with an average debt level just over 90% of GDP. In terms of fiscal consolidation, this puts the euro area significantly ahead of some other advanced economies.

How to deal with intra-euro area competitiveness imbalances?

Ensuring debt sustainability is to a large degree linked to the second question of today's panel: how to deal with intra-euro area competitiveness imbalances?

To some extent, this question is already answered. Rebalancing is happening. Large competitiveness adjustments are taking place in the so-called periphery.

The countries under full EU-IMF programmes have seen unit labour costs improve by around 10% since 2008, relative to the euro area average. Current account deficits are on average 8 percentage points of GDP lower than they were then.

But to ensure that this competitiveness improvement is structural rather than cyclical, three further elements are crucial.

First, continued and determined reform. And this ultimately has to go beyond economic policies and into fundamental issues of governance, like public administration, judiciary and education.

Second, the completion of Europe's Single Market. It does not serve citizens to protect local monopolies that lead to high prices and low quality. Europe has some of the world's most sophisticated and innovative companies, and they should be operating on a European scale.

Third, stronger economic governance. We have already made some progress here with a new procedure to monitor and correct euro-area imbalances. But we also need to find better ways to incentivise continued structural reform, including through the use of common funds.

All these measures are of course relevant for the country most in the media spotlight, Greece. A lot has been done by the Greek authorities in last two years. The primary deficit has been reduced by more than 8 pp from end-2009 to end-2011. Labour market reforms are beginning to show positive results.

But a lot still remains to be done. The Greek authorities have to demonstrate that they can continue to stick to their commitments. We are seeing encouraging signs that the fiscal targets for next year can be met. This is the best way out of its crisis: for Greece to reform within the euro area.

Where does the euro area go from here?

Addressing these imbalances would go a long way towards putting the euro area on a sustainable path. This leads into the third question: where does the euro area go from here?

First of all, we should acknowledge that the euro area has done a huge amount of institution-building in the last two years. Few would have predicted, in early 2010, that we would today have an international treaty ensuring balanced budgets and a permanent rescue fund of 500 billion euro.

But to fully restore confidence in the euro area, we also need to fix the flaws in its institutional architecture. The euro area is drawing up a roadmap to complete EMU based on four key pillars: financial market union, fiscal union, economic union and political union.

On financial market union, progress is already being made with the agreement to establish a single supervisory for euro area banks. In order to prevent moral hazard, it is important that this is complemented with an integrated framework for bank resolution.

For the other unions, the roadmap aims to strengthen oversight of policies, furnish the euro area with the shock-absorbing institutions that we see in other monetary unions, and provide a proper outlet for citizens to express their views.

Thank you for your attention.