Peter Praet: Interview in *der Standard*

Interview with Mr Peter Praet, Member of the Executive Board of the European Central Bank, in *der Standard,* conducted by Mr Andras Szigètvari on 10 June 2015 and published on 13 June 2015.

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Standard: Mr Praet, the role of the ECB has changed since the outbreak of the crisis. You are now engaging in political debate, telling countries what reforms to implement. Hasn't the ECB stretched its mandate in order to maintain price stability?

Praet: As you know, the ECB takes monetary policy decisions to achieve its objective of maintaining price stability. We make our voice heard on structural reforms when it is considered necessary in the context of our mandate under the Treaty. And, as Mario Draghi indicated in Sintra, *for members of a monetary union, resilience is crucial to avoid that shocks lead to permanent economic divergence over time – it therefore has direct implications for price stability*. In this sense, we are different from, for example, the Federal Reserve in the United States, which would never engage in such a debate.

We frequently get the advice that we should just concentrate on our core business – monetary policy. But, in a currency union like the euro area, individual countries have lost the flexibility provided by an exchange rate of their own. They must thus become more resilient to crises and external shocks. Sound governance and effective institutions are of key importance. That applies, among other things, to labour and product markets, or courts and administration. They are needed for a more efficient monetary policy in a currency union and therefore we tell governments that structural reforms are important. Here, our interest is not in how countries implement these reforms, that is up to them. What interests us is if they are successful, as this impacts the monetary union as a whole. However, I would also like to make the self-critical comment that, in the past, our messages have sounded too much like a mantra.

Standard: What do you mean?

Praet: In several respects, countries are similar as they are part of a monetary union, but in many respects they differ as a result of their national conditions. So there are various combinations of structural reforms that work – there is no "one-size-fits-all" model. We must make this clear, otherwise there may be the impression that our citizens don't have much of a choice. We must convey to them the fact that reforms also allow for diversity.

For example, it is not enough to merely say publicly that a country's labour market must become more flexible. Otherwise, people take this as meaning that it should become easier to fire people. That is wrong. In Germany, for example, after the dramatic contraction in demand as a result of the 2008 crisis, firms did not get rid of workers. Unions accepted wage reductions or shorter working hours and that prevented a worse decline. Thus, despite apparent rigidities, the labour market responded in a very flexible way. Also, countries can be wealthy and stable without all having to implement the same policies. The United States and Sweden are two good examples: labour markets are very different there, but people in these countries still have a good standard of living.

Standard: What you're saying sounds good in theory. But within the Troika, the ECB has always demanded of Portugal and Greece that they weaken protection against layoffs and soften collective wage agreements. There hasn't really been that much room for manoeuvre.

Praet: Our job in the Troika is to support the EU Commission in its work. That is technical work and, at the end of the day, it's the Eurogroup that makes the political decision as to which direction should be followed, since it represents the elected governments and therefore European taxpayers. It must also be clear that not every political solution is feasible, as social systems must remain fundable. Still, I hope that, in the future, there will be a greater focus on giving countries more ownership of their reform programmes; they should act on their own initiative and take responsibility.

Standard: But is it possible to really change a country, when it's trying to make savings?

Praet: As the crisis took effect, investors' trust in the sustainability of several countries' debt was eroded. The ensuing adjustment of public finances was therefore implemented looking mainly at the short-term effects. Frequently, public investments were cut and value-added taxes were raised in order to obtain quick debt reduction, even if this weighed on growth prospects. At the same time, however, certain countries have reformed successfully – their labour markets have become more flexible and banks have been restructured. That wasn't easy and it was also painful, but they are growing again.

Standard: But even your colleagues are saying that a radical course of austerity isn't the right medicine, for example, in the case of Greece.

Praet: Allow me to make a general point: institutional standards in many countries that faced challenges were particularly low. The World Bank, and also the IMF, issue some well-known rankings on good governance and solid institutions. These show that there is a clear correlation between the per capita GDP of a country and its position in such rankings. Some countries rank very low in terms of all criteria related to good governance. Competitiveness can be regained by making it cheaper to produce goods. However, so long as the business environment remains unchanged, the results will not be satisfactory. This problem was already touched upon in the first reform programmes. But too little importance was attached to the problem of governance standards.

Standard: Earlier on, you talked about "ownership". But this implies that a government which does not believe in reform measures shouldn't implement them.

Praet: At the end of the 1970s, I worked as an economist for the IMF. At that time, requests for aid from states, the so-called "letter of intent", were pre-written by IMF staff, but then sent by these countries to the IMF as their own letters. Even though the content was the outcome of discussions, that was, of course, somewhat strange. But the IMF gave that money and imposed the conditions, so that was the understanding of "ownership" then. I believe that we have learnt from this.

Standard: But in the case of Greece, this means that, no matter what the left-wing Syriza government signs, it can't work as long as they don't believe in it themselves.

Praet: Because of the ongoing negotiations, I won't comment on Greece. Fundamentally, mutual trust and credibility are of critical importance in such situations. This means that when a country agrees to do something, it has to implement the agreement. The more credible a country is, the more patient creditors can be and the more trust they can show. That goes for all countries: if a government is trusted, it doesn't mean so much if an agreed figure is not reached exactly in a year. The problem is that if you lose this confidence, the situation becomes messy and creditors then immediately press for results.

Standard: Jean-Claude Trichet, the former President of the ECB, was an active letter-writer: he wrote a letter to Ireland, threatening to cut aid to the country if it didn't accept an aid programme and agree to reforms. He later exerted pressure on the Berlusconi government in Rome and the Socialists in Spain. Did that not go beyond the ECB's mandate?

Praet: I won't comment on those letters. However, I would say that, before the outbreak of the financial crisis, we in the euro area invested too little in institutions that would've been available for emergencies. Consequently, institutions dealing with banking crises were too weak.

Standard: Independence is very important for central banks. Does the question also have to be put differently in public now: to what extent is a central bank allowed to get involved in politics?

Praet: I would put it this way: because there were no sufficiently effective crisis management institutions when the crisis erupted, the ECB could not have simply ignored the potential consequences of the banking crisis for price stability. In the light of its mandate, the ECB couldn't accept that.

Standard: The Greek Prime Minister, Alexis Tsipras, said this week that it would be a disaster if his country left the euro because the whole world would see that the euro is reversible. How do you see it?

Praet: Let me reiterate what Mario Draghi said in the ECB press conference a week ago: the Governing Council of the ECB wants Greece to remain a member of the euro.

Standard: Mr Praet, what does it feel like to be a thief?

Praet: A thief?

Standard: Yes. That's how many people in Austria would describe you. After all, you and your colleagues at the ECB have, de facto, abolished interest rates. Anybody who puts their money in a savings account hardly receives anything now.

Praet: I'm sure that most Austrians feel confident that our monetary policy is the appropriate and necessary reaction to the weak economic conditions and the extraordinarily low inflation rates, which are far below our monetary policy objective of below, but close to, 2%. The low interest rates were an issue for some savers. However, for them, it is not the nominal interest rates which we influence directly that are decisive, but rather the real interest rates – after inflation has been deducted – that count. In the past, there were very long periods in which real interest rates were significantly lower than today, simply because inflation was so high. Also, in the longer run, what is crucial for the real income of the savers is the state of the economy. A central bank has no influence on factors which determine the structural strength of an economy and thus the real, or inflation-adjusted, interest rates.

Standard: That's not much help to savers today.

Praet: In the medium to longer term, our monetary policy will certainly help savers. We're doing our part to help the economy recover. This will bring the rate of inflation back to our objective and subsequently bring the level of interest rates back to normal. Therefore, the low interest rates may be a short-term pain for some, but a long-term gain for all. Everybody in Europe has an interest in us getting out of the current situation, which is marked by low inflation and low growth. We will succeed in doing so. But the crisis was so severe that this process is taking a number of years.

Standard: Some economists say that it'll be years before interest rates are higher.

Praet: There are always Cassandras who speak badly about everything…

Standard: Cassandra was right about her warnings.

Praet: Yes, but prophecies that make people scared and become self-fulfilling can be dangerous.

Standard: The ECB started buying government bonds on a massive scale in January 2016. Have you got any proof that the quantitative easing programme is taking effect?

Praet: Yes. The first effect is that we have given a clear signal. When we lowered interest rates, credit conditions for companies in some countries rapidly improved. Now, with quantitative easing in the background, loans for firms and the government sector have become significantly cheaper overall.

Standard: Austria is the first country in Europe to have initiated a bail-in, namely in the case of Hypo Alpe Adria. Why don't EU institutions give more support to [this measure]? After all, it's something that's been fought for years.

Praet: We support the bail-in clause in the EU's Bank Resolution and Recovery Directive. However, I cannot comment on specific cases, which come under the supervision of the Single Supervisory Mechanism.